Petition and Transcript of Record

Supreme Court of the United States

OCTOBER TERM, [redacted] 1928

No. [redacted] 31

BOTANY WORSTED MILLS, PETITIONER,

vs.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED DECEMBER 22, 1927

CERTIORARI GRANTED FEBRUARY 27, 1928.

(33,111)

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1927

No. 659

BOTANY WORSTED MILLS, PETITIONER,

vs.

THE UNITED STATES

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

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[fol. 1]

SUPREME COURT OF THE UNITED STATES

BOTANY WORSTED MILLS, Petitioner,

v.

THE UNITED STATES OF AMERICA, Respondent

PETITION FOR WRIT OF CERTIORARI

To the Honorable Supreme Court of the United States:

Your petitioner, Botany Worsted Mills, a corporation, respectfully represents

1. That on September 12, 1924, Petitioner brought an action against the United States in the Court of Claims for the recovery of $450,994.06, alleged to have been illegally assessed against and collected from it as part of its income tax for the year 1917. Such assessment was due to the disallowance by the Commissioner of Internal Revenue, as a deduction, of a portion of the amounts paid by Petitioner as compensation to its directors for the said year.

On defendant's failure to plead a general traverse was entered under Rule 34 of the Court of Claims. As stated in the court's opinion, the Government interposed two defenses: first, "that the amount paid the directors for 1917 was unreasonable compensation; and, second, that in 1919 the various tax matters of plaintiff for 1917 were finally settled by compromise and mutual agreement." (p.23).

On April 4, 1927, the Court of Claims handed down its opinion. It held that the disallowance was erroneous, but sustained the second defense.

In its findings of fact (No. XIX) the Court stated:

[fol. 2] "An investigation of the books of the plaintiff by a representative of the defendant disclosed to the Commissioner of Internal Revenue the necessity of making a different assessment against the plaintiff than appeared due from its said return for the year ending November 30, 1917. The taxes for the said year were to be determined by the settlement of questions relating to the bonus paid to the company's directors, excessive depreciation charged off

on the books of the company, and reserves charged to expenses.

"After much correspondence and numerous conferences extending over a period of several months in which the plaintiff was represented by its attorney, John Quinn, and by its assistant treasurer, W. J. Helmer, and other parties, and the defendant represented by Sidney Alexander, chief of the special audit section, Bureau of Internal Revenue, and others of his official associates *a compromise* was *agreed to* as to all of the differences. In the said conferences Alexander informed Quinn that in view of the fact that the organization controlled by the Alien Property Custodian had considered the compensation paid to the directors for the year 1918 as being fair and reasonable, the same conclusion 'could be reached upon the part of the Government in considering it a fair and reasonable amount for 1917.' The results of the said conferences were reported by Quinn to the plaintiff's board of directors from time to time during their continuance.

* * * * * * *

"Thereafter amended returns were prepared and executed by plaintiff's executive officers, based upon the figures as agreed upon in the said conferences, and were filed with the Commissioner of Internal Revenue together with documentary evidence which it was agreed upon at the last conference should be furnished, and the tax so computed, with a slight change not material to this case, was paid by the plaintiff." (pp. 18-20. Italics ours.)

(Note.—The portion of the findings omitted above is a quotation from the evidence of an excerpt from the minutes of a meeting of your petitioner's board of directors. Otherwise the only findings relating to the alleged compromise have been here set forth in full.)

In its opinion, the court said,

"It is not claimed by the Government that plaintiff's taxes were settled under the provisions of section 3229. The theory upon which its defense on this point is based is that an agreement was entered into between plaintiff and the Commissioner of Internal Revenue under which plaintiff

accepted the partial disallowance as to compensation, and also received certain concessions as to other disputed items, the benefit of which it still enjoys, and that, therefore, plaintiff is estopped from recovery in this action.

* * * * * * *

"With the payment of the tax under the circumstances [fol. 3] surrounding this case the agreement, which is mentioned in the record as a 'gentleman's agreement,' *became in legal effect an executed contract of settlement.* Plaintiff now seeks to recover on account of the particular item which it regards as unfavorable to its interests, and at the same time hold to the advantage from the settlement of other items in dispute involved in the same general settlement." (pp. 24-26. Italics ours.)

Sec. 3229 of the Revised Statutes, referred to by the court, was the only statutory source of authority for the compromise of tax cases existing at the time. There was then in force Article 38 of the Regulations of the Treasury Department under the Act of 1918 (Regs. No. 33 Revised, promulgated January 2, 1918) which reads as follows:

"Treasury decisions promulgating rulings of the Internal Revenue Bureau become effective upon the date of approval unless otherwise stated therein. Cases previously adjusted in contravention of law as pronounced in such decisions, are subject to readjustment in accordance with the decision."

Judgment was directed against petitioner on April 4, 1927. A motion for a new trial, filed May 17, was denied on November 7, 1927.

II. That the judgment of the Court of Claims of the United States is erroneous and that this Honorable Court should require that this action be certified to it for its review and determination.

III. That the ground upon which this writ is requested is that the Court of Claims has decided an important question of federal law which has not been, but should be, settled by this Court, and has decided such question in a way in conflict with the applicable decisions of this Court.

IV. That the reasons relied on for the allowance of this writ are as follows:

1. The Court of Claims has held in this case that an oral compromise agreement, made otherwise than as authorized [fol. 4] by statute, between subordinate officials of the Bureau of Internal Revenue and a taxpayer, may, when followed by the filing of an amended return and payment of the tax in accordance with the figures agreed on, become, in legal effect, an executed contract of settlement. Such decision is believed by Petitioner to be contrary to doctrines long and clearly established relating to the authority of public officers. It asserts a power in the Commissioner of Internal Revenue, and his subordinates, to bind the United States to contracts in compromise of tax cases made otherwise than in accordance with the express authority granted by statute and thus to override the limitations on his authority prescribed by the statute.

The decision of the Court of Claims is, furthermore, contrary to the view which has heretofore been held by the Bureau of Internal Revenue and the Attorney General and is now being asserted by them in other important pending cases, (including one before the Board of Tax Appeals and one before the Circuit Court of Appeals for the Sixth Circuit) to the effect that an agreement between the Government and a taxpayer, made otherwise than pursuant to the provisions of the statute, cannot be effective either as a valid settlement contract or as binding the parties by estoppel.

Since the date of the alleged compromise in this case, Congress has enacted statutes (Sec. 1312 of the Revenue Act of 1921, substantially repeated in Sec. 1006 of the Revenue Act of 1924) providing a new method by which a final settlement may be made in tax cases by agreement in writing between the taxpayer and the Commissioner, with the approval of the Secretary of the Treasury. If the decision of the Court of Claims in this case is not reviewed and reversed by this court, it will stand as a precedent whereunder the provisions of the Acts of 1921 and 1924, made for [fol. 5] the protection both of taxpayers and the United States, may be circumvented.

The law has been left by the decision of the Court of Claims in a state of perplexing uncertainty. In holding

that an unauthorized compromise between the Government and a taxpayer may, under certain circumstances, become effective as an executed contract of settlement, it has failed to make clear what circumstances may be effective to take the place of the requirements set forth in the statute.

2. If the decision of the Court of Claims herein was based on an equitable estoppel, it is in conflict with the applicable decisions of this Court in the following respects:

(a) There is no finding, as an ultimate fact, that any benefit was received by Petitioner in the compromise in respect of any item other than directors' compensation or that any concession was made to it to which it was not entitled as matter of prior right. The findings include a fragment of the evidence (contrary to the rules of this Court) and, in its opinion, the Court of Claims has drawn from such fragment an unwarrantable inference of the existence of facts which it has not found.

(b) Estoppel was not pleaded and was therefore waived by the defendant. It was not in issue in the case.

(c) Even if benefits to which it was not entitled were conceded to your petitioner in the unauthorized compromise, such fact should not constitute a complete bar to recovery but should, at most, be given consideration only to the extent of permitting the Government to establish the existence and amount of such benefits by way of counterclaim [fols. 6 & 7] or offset.

Wherefore your petitioner respectfully prays that a writ of certiorari be issued under the seal of this Court, directed to the Court of Claims of the United States, commanding the said Court to certify and send to this Court on a day to be designated a full and complete transcript of the record in that Court had in said cause, to the end that the judgment of the said Court of Claims may be reviewed by this Honorable Court as provided by the Statutes of the United States; and that the said judgment of the Court of Claims be reversed by this Honorable Court, and for such further relief as may seem proper.

And your petitioner will ever pray.

Botany Worsted Mills, Petitioner. Nathan A. Smyth, Counsel.

STATE OF NEW YORK,
County of New York, ss:

Alfred De Liagre, Secretary of Botany Worsted Mills, the claimant corporation, being duly sworn, deposes and says: I am Secretary of Botany Worsted Mills, the petitioner in this case. I have read the above petition and the matters therein stated are true, to the best of my knowledge and belief.

Alfred De Liagre. (Seal Botany Worsted Mills, Incorporated, 1889, Passaic, N. J.) Subscribed and sworn to before me this 21st day of December. Harry W. Bohmke, Notary Public. Kings Co. Clerk's No. 257. Reg. No. 8253. N. Y. Co. Clerk's No. 532. Reg. No. 8412. Commission Expires March 30, 1928. (Seal Harry W. Bohmke, Notary Public, Kings County.

[fols. a & 1] IN COURT OF CLAIMS OF THE UNITED STATES

No. D-747

BOTANY WORSTED MILLS, a Corporation,

vs.

THE UNITED STATES

I. PETITION—Filed September 12, 1924

To the Honorable The Court of Claims:

The claimant, Botany Worsted Mills, respectfully represents:

I

The claimant is a corporation duly organized and existing under and by virtue of the laws of the State of New Jersey, having its principal office at Passaic in said State and is now and was during all of the times hereinafter mentioned engaged in the general business of manufacturing woolen and worsted fabrics and selling the same throughout the United States and elsewhere.

II

Under the provisions of an act of Congress approved September 8, 1916, entitled "An act to increase the revenue and for other purposes" (39 Stat. L. 756) and an act of [fol. 2] Congress approved October 3, 1917, entitled "An act to provide revenue, to defray war expenses and for other purposes" (40 Stat. L. 300) and regulations of the Treasury Department entitled "Regulations No. 33 covering the collection of the income tax imposed by the act of September 8, 1916, as amended by the act of October 3, 1917," approved by the Secretary of the Treasury on January 2, 1918, the claimant prepared and filed its return of net income for the taxable year ending November 30, 1917. Claimant endeavored to make its said return in strict accordance with the requirements of the said statutes and regulations, and the claimant paid on, to wit, June 14, 1918, to the United States, taxes in the sum of $2,981,167.77 in accordance with the return filed as aforesaid.

III

In the said return for the year ending November 30, 1917, the claimant, acting in pursuance of Section 12 of an act of Congress approved September 8, 1916, entitled, "An Act to increase the revenue and for other purposes" (39 Stat. L. 756) and the said Treasury Department Regulations promulgated thereunder and approved by the Secretary of the Treasury as aforesaid, deducted compensation paid to its Board of Directors for the said taxable year, aggregating $1,565,739.39 in addition to other nominal salaries received by the individual members of said Board.

IV

The said sum of $1,565,739.39 was an obligation of the claimant for the taxable year ending November 30, 1917, by virtue of the several contracts, agreements and undertakings of employment between the claimant and the several members of the Board of Directors under the following circumstances:

[fol. 3] In the year 1889, prior to the employment of any of the members of the said Board of Directors, the claimant corporation incorporated in its by-laws the following—

"Par. 2. At the close of the business year the net profits shall be distributed as follows after suitable deductions shall have been made from the value of the property of the Company:

(1) A dividend of six (6%) per centum is to be paid to the stockholders in the computation of which said dividend payable on September 15th of the same business year shall be included.

(2) The balance remaining is to be applied as follows:

(a) Five (5%) per centum thereof shall be placed in a reserve fund until the amount of the reserve fund accumulated shall be equal to twenty (20%) per centum of the paid up capital of the Company for the time being.

(b) A compensation equal to thirty-two (32%) per centum of the said balance shall be allowed or paid to the Board of Directors for their services."

The said provision remained in the by-laws of the claimant corporation from that day until after the close of the taxable year 1917 and was in force and effect at the times that all of the several members of the Board of Directors were employed by the corporation and annual payments were made in accordance therewith, from 1889 until after the close of the taxable year 1917. The said sum of $1,565,739.39 was a sum equal to 32% of the balance of the net profits for the taxable year 1917 after the several deductions provided for in the said by-laws were made.

[fol. 4] V

On to wit, September 11, 1919, the Commissioner of Internal Revenue without legal authority disallowed as a deduction a portion of the said sum of $1,565,739.39 compensation of the Board of Directors, to wit, $783,656.06 of said sum. On or about the 17th day of June, 1920, an additional assessment in the aggregate sum of $703,578.37 was made against the claimant and the said sum was paid by the claimant to the United States on or about June 28, 1920. Of this amount $450,994.06 was attributable to the illegal disallowance by the Commissioner of Internal Revenue of the said sum of $783,656.06, a part of the compensation of the members of the Board of Directors, as a deduction for the taxable year 1917.

VI

On or about February 1, 1922, the claimant filed with the Commissioner of Internal Revenue a claim for refund of the said sum of $450,994.06 and the said claim was disallowed by the Commissioner of Internal Revenue on or about September 26, 1922.

VII

Under Sections 1019 and 1020 of the Revenue Act of 1924, the claimant may be allowed interest at the rate of 6% per annum on the said sum of $450,994.06 from June 28, 1920, the date of payment thereof.

VIII

The claimant therefore prays judgment against the United States in the sum of $450,994.06, together with interest thereon at 6% from June 28, 1920.

[fol. 5] IX

No action, other than as aforesaid, has been had on said claim in Congress or by any of the Departments; no person, other than the claimant, is the owner thereof or interested therein; no assignment or transfer of this claim or any part thereof or interest therein has been made; the claimant is justly entitled to the amount herein claimed from the United States after allowing all just claims and offsets; the claimant has at all times borne true allegiance to the government of the United States and has not in any way voluntarily aided, abetted, or given encouragement to rebellion against the said government. The claimant is a citizen of the United States. And the claimant claims $450,994.06 together with interest at 6% from June 28, 1920.

Davies & Jones, Attorneys for Claimant.

Duly sworn to by Alfred De Liagre. Jurat omitted in printing.

[fol. 6] II. General Traverse—Nov. 12, 1924

No demurrer, plea, answer, counterclaim, setoff, claim of damages, demand, or defense in the premises, having

been entered on the part of the defendant, a general traverse is entered as provided by Rule 34.

III. Substitution of Attorney

On August 13, 1925, on motion made therefore, Nathan A. Smyth, Esq., was substituted as attorney of record, without prejudice to any lien or interest of the former attorneys.

IV. Argument and Submission

On November 8, 1927, this case was argued and submitted on merits by Mr. Nathan A. Smyth, for the plaintiff, and by Mr. R. C. Williamson, for the defendant.

[fol. 7]

V. **Special Findings of Fact, Conclusions of Law, and Opinion of the Court by Moss, J.**—April 4, 1927

This case having been heard by the Court of Claims, the court, upon the report of a commissioner and the evidence, makes the following

Special Findings of Fact

I

The plaintiff is a corporation duly organized and existing under and by virtue of the laws of the State of New Jersey, having its principal office at Passaic in said State, and is now and was during all of the times hereinafter mentioned engaged in the general business of manufacturing and selling woolen and worsted fabrics.

II

Under the provisions of an act of Congress approved September 8, 1918, entitled "An act to increase the revenue, and for other purposes," 39 Stat. 756, and an act of Congress approved October 3, 1917, entitled "An act to provide

revenue, to defray war expenses, and for other purposes," 40 Stat. 300, and regulations of the Treasury Department entitled "Regulations No. 33 covering the collection of the income tax imposed by the act of September 8, 1916, as amended by the act of October 3, 1917," approved by the Secretary of the Treasury on January 2, 1918, the plaintiff prepared and filed its return of net income for the taxable year ending November 30, 1917. Plaintiff paid to the United States, on June 14, 1918, taxes in the sum of $2,291,167.77, in accordance with the return filed.

III

In the said return for the year ending November 30, 1917, the plaintiff deducted amounts paid to the members of its board of directors for the said taxable year, aggregating $1,565,739.39, in addition to salaries of $9,000 each, received by the individual members of said board. The said sum of $1,565,739.39 was a sum equal to 32 per cent of the balance of the net profits for the taxable year 1917 and was paid in accordance with and after making the several deductions provided for in the by-laws of the plaintiff corporation.

[fol. 8]

IV

On September 11, 1919, the Commissioner of Internal Revenue disallowed as a deduction a portion of the said sum of $1,565,739.39, so paid as compensation to the members of the board of directors, to wit, $783,656.06 thereof. On or about the 17th day of June, 1920, an additional assessment in the aggregate sum of $703,578.37 was made against the plaintiff, and the said sum was paid by the plaintiff to the United States on or about June 28, 1920. Of this amount $450,994.06 was attributable to the said disallowance by the Commissioner of Internal Revenue of the said sum of $783,656.06, a part of the amounts paid to the members of the board of directors as a deduction for the taxable year 1917. Notices of said additional assessment were sent to plaintiff on June 15, 1920, and June 17, 1920, respectively. The disallowance so made was on the ground that the amounts paid as compensation were unreasonable, and that the deductions allowed represented fair and reasonable compensation.

V

On or about February 1, 1922, the plaintiff filed with the Commissioner of Internal Revenue a claim for refund of the said sum of $450,994.06, and the said claim was disallowed by the Commissioner of Internal Revenue on or about September 26, 1922.

VI

The plaintiff was incorporated in May, 1889, with an original authorized capital stock of $1,100,000. The authorized capital stock was increased in 1890 to $1,750,000, in 1899 to $2,500,000, in 1903 to $3,000,000, and in 1908 to $3,600,000.

VII

The plaintiff was organized by Eduard Stoehr, who was the head of a firm of woolen manufacturers doing business in Leipzig, Germany, known as Kammgarn-Spinnerei Stoehr & Company. A meeting of the stockholders of the plaintiff was held on January 11, 1890. From the records of that meeting it appears that at that time the owners of 9,180 shares out of the total 11,000 of authorized stock were citizens and residents of Germany. Of these shares 7,000 were owned by Kammgarn-Spinnerei Stoehr & Company, and 500 were owned by Eduard Stoehr. At that meeting of the stockholders the by-laws of the company were unanimously adopted. Said by-laws contained the following provisions:

"Article 22. Distribution of Profits

"Par. 1. After the close of every half of the business year of the company a computation of profits shall be made, and if practicable a dividend not exceeding three per centum shall be paid to the stockholders.

[fol. 9] "Par. 2. At the close of the business year the net profits shall be distributed as follows, after suitable deductions shall have been maide from the value of the property of the company:

"'(1) A dividend of six per centum is to be paid to the stockholders, in the computation of which any dividend or dividends already paid to the stockholders during the same business year shall be included.

" 'The balance remaining is to be applied as follows:

" '(a) Five per centum shall be placed in a reserve fund until the amount of the reserve fund thus accumulated shall be equal to twenty per centum of the paid-up capital of the company for the time being.

" '(b) Twenty-five per centum is to be paid as a bonus to the board of directors.

" '(c) Seventy per centum is to be paid as additional dividend to the shareholders.'

"The board of directors may, however, with the consent of the majority of the shareholders, use a portion of the amount mentioned in the last paragraph, marked 'c' for special deductions from accounts or for the formation of a special reserve fund or for extra compensation to be paid to employees or for any institutions which will benefit the employees, such as pension funds and the like."

VIII

The said article 22 of the by-laws, adopted January 11, 1890, remained unchanged until April 11, 1903, at which time it was amended at a stockholders' meeting so that subdivision 2-b of paragraph 2 thereof read: "Forty per centum is to be paid as a bonus to the board of directors."

IX

The said subdivision 2-b of paragraph 2 of article 22 of the by-laws remained the same (except that said article was renumbered article 21 in August, 1904) until March 21, 1905, when it was amended at a meeting of the stockholders to read as follows:

"2-b. A compensation equal to forty per centum of the said balance shall be allowed or paid to the board of directors for their services."

X

The said subdivision 2-b remained unchanged until a meeting of the stockholders held on March 17, 1908, when article 21 of the by-laws was amended so that as a whole it read as follows:

"Par. 1. After the close of the first half of every business year of the company a computation of profits shall be made, and if practicable a dividend not exceeding three (3) per centum shall be paid to the stockholders. This dividend shall be payable on September 15th following.

"Par. 2. At the close of the business year the net profits shall be distributed as follows, after suitable deductions shall have been made from the value of the property of the company:

[fol. 10] "(1) A dividend of six (6) per centum is to be paid to the stockholders, in the computation of which said dividend payable on September 15th of the same business year shall be included.

"(2) The balance remaining is to be applied as follows:

"(a) Five (5%) per centum thereof shall be placed in a reserve fund until the amount of the reserve fund accumulated shall be equal to twenty (20%) per centum of the paid-up capital of the company for the time being.

"(b) A compensation equal to thirty-two (32%) per centum of the said balance shall be allowed or paid to the board of directors for their services.

"(c) The residue is to be applied to the payment of an additional dividend to the stockholders, which is to be determined by the board of directors, subject to the approval of the stockholders at the annual meeting assembled. The board of directors may, however, with such approval of the stockholders, use a portion of said residue referred to in this paragraph (c) for special deductions from accounts or for the formation of special reserve funds or additional reserves, or for extra compensation to be paid to employees, or for any institutions which are designed to benefit the employees, such as pension funds and other similar institutions.

"Said additional dividend shall be payable on April 15th following the declaration thereof, unless the directors, with the approval of the stockholders, appoint another day for its payment."

The foregoing provisions remained in force until after the close of the taxable year 1917, and during that period compensation was paid to the directors in accordance therewith.

XI

The directors of plaintiff for the year 1917 were Thomas Prehn, Ferdinand Kuhn, Hans E. Stoehr, Max W. Stoehr, George Roehlig, Camill A. Mehl, Otto Kuhn, A. de Liagre, Edward Stoehr, and George Stoehr.

During the early part of the year 1918, 25,605 shares of the stock of the plaintiff were seized as alien property by the Alien Property Custodian, who by virtue of such control on the 2d day of April, 1918, caused a new board of directors of the plaintiff corporation to be elected. Such board consisted of:

Francis P. Garvan.
Horace C. Jones.
Andrew B. Duvall.
George T. Smith.
Max W. Stoehr.
Ferdinand Kuhn.
James N. Wallace.
Thomas J. Maloney.
H. C. McEldowney.
Thomas Prehn.
George Roehlig.

Of this board Messrs. Prehn, Stoehr, Roehlig, and Kuhn had previously been connected with the company. The other seven were nominees and representatives of the Alien Property Custodian. Mr. Garvan was at that time chief of the bureau of investigation in the Alien Property Custodian's office and in March, 1919, became Alien Property Custodian.

[fol. 11] XII

Subdivision 2-b of the by-laws was in effect all of the year 1917 and until July 30, 1918, when said subdivision 2-b was amended by the stockholders to read as follows:

"(b) Such sum, not exceeding thirty-two per cent (32%) thereof, as the board of directors shall in its sole discretion determine, shall be paid to the members of the board of directors and officers and executives or any of them as additional compensation for their services. Each such director,

officer, and executive shall receive of said sum such proportion as shall be determined by the board of directors. Said proportion may as to any one or more of said directors, officers, and executives be so determined after the close of said business year, or in the sole discretion of the board of directors at any time, prior to the close of said business year by contract between the company and such director, officer, or executive."

At the time of this amendment the Alien Property Custodian of the United States was the holder of record and voted the majority of the stock of the plaintiff.

XIII

From the outset the determination of the total amount of profits of the company and of the aggregate amount payable to the board of directors in accordance with the by-laws, was made by the board of directors. The basis of apportionment among the several directors of the aggregate amount payable to the board of directors as a whole, in accordance with the by-laws, was up to the year 1917 recommended to the board by its chairman, Eduard Stoehr, in conjunction with the treasurer and vice president. In the year 1918, Eduard Stoehr being in Germany, the apportionment was recommended by Hans Stoehr, treasurer of the company, in conjunction with a committee consisting of the president, Thomas Prehn, and the vice president, Ferdinand Kuhn.

XIV

No written or oral contract was at any time made with any of the directors as to what his compensation should be, other than such contract as was implied from his election to and acceptance of membership on the board, and his service as such a member in accordance with the by-laws and customary practices of the company, which were known to each such director. At all times each director held a position as an executive officer or manager of a department in the company. In 1918 express agreements were made between the company and the directors for a fixed salary and guaranteed bonus.

The ~~next~~ Net income of the plaintiff in the years indicated was as follows:

1910	$784,334.44
1911	456,440.02
1912	618,402.80
1913	497,090.61
1914	844,181.46
1915	1,393,922.43
1916	2,694,150.89
1917	7,953,512.80
1918	6,796,387.56

[fol. 12]

XV

The plaintiff paid to the directors in pursuance of the aforementioned by-laws the following amounts:

1910	$268,444.19
1911	132,704.85
1912	217,395.64
1913	169,925.00
1914	218,026.67
1915	400,935.18
1916	693,617.16
1917	1,565,739.39
1918	593,416.96

The plaintiff took credit in its tax returns for said payments in the years 1010, 1911, 1912, 1913, 1917, and 1918. In the years 1910 to 1916, inclusive, the Government did not allow any deduction for the amounts so paid and plaintiff paid its taxes accordingly for said years.

XVI

The gross assets of the plaintiff and its net assets, including reserves, as shown by its balance sheets, were as follows:

	Gross assets	Net, including reserves
1890	$1,114,149.63	$37,136.35
1900	8,888,243.37	2,138,306.56
1910	14,234,978.83	4,743,592.93
1917	28,893,777.12	10,999,862.48

XVII

At a meeting of the board of directors of the plaintiff, held March 25, 1918, the following resolution was adopted:

"Resolved, That the balance sheet and profit and loss account be spread in full on the minutes of the company; that the amount of four hundred thousand dollars ($400,000) be set aside for depreciation and also the amount of two hundred sixteen thousand dollars ($216,000), being six (6%) per cent dividend on the capital stock of the company, including three (3%) per cent dividend paid on September 15, 1917, as well as the compensation of the board of directors for the year 1917, namely thirty-two (32%) per cent of five million three hundred forty-five thousand seven hundred twenty-four dollars and thirty-five cents ($5,345,724.35), being equal to one million seven hundred ten thousand six hundred thirty-one dollars and seventy-nine cents ($1,710,631.79) be credited to the members of the board of directors in accordance with the by-laws of the company."

XVIII

On April 15, 1918, John Quinn was, at the suggestion of the Alien Property Custodian, duly elected counsel for the plaintiff company at a meeting of its board of directors, held on that day, and ceased to be counsel on March 29, 1921.

[fol. 13]

XIX

An investigation of the books of the plaintiff by a representative of the defendant disclosed to the Commissioner of Internal Revenue the necessity of making a different assessment against the plaintiff than appeared due from its said return for the year ending November 30, 1917. The taxes for the said year were to be determined by the settlement of questions relating to the bonus paid to the company's directors, excessive depreciation charged off on the books of the company, and reserves charged to expenses.

After much correspondence and numerous conferences extending over a period of several months in which the plaintiff was represented by its attorney, John Quinn, and by its assistant treasurer, W. J. Helmer, and other parties, and

the defendant represented by Sidney Alexander, chief of the special audit section, Bureau of Internal Revenue, and others of his official associates, a compromise was agreed to as to all of the differences. In the said conferences Alexander informed Quinn that in view of the fact that the orginzation controlled by the Alien Property Custodian had considered the compensation paid to the directors for the year 1918 as being fair and reasonable, the same conclusion "could be reached upon the part of the Government in considering it a fair and reasonable amount for 1917." The results of the said conferences were reported by Quinn to the plaintiff's board of directors from time to time during their continuance.

The following is an excerpt from the minutes of a meeting of plaintiff's board of directors held April 23, 1920:

"* * * Counsel succeeded some time ago in effecting a compromise on the question of bonuses to directors and the amount transferred from depreciation on buildings and machinery to the surplus account, as to which counsel made a report to the board and which was satisfactory to the board.

"The company then received an assessment of $1,144,821.02, covering the years 1916, 1917, and part of 1918. This assessment was the subject of careful consideration by the company and conferences with counsel and conferences with the department by counsel, and the subject of supplemental memoranda and hearings.

"At the last hearing there was a great deal of discussion in regard to the reluctance of the department to allow for those years the large items of bonuses to employees and deductions for reserves, but they finally agreed to allow the bonuses to employees, the deductions for reserves, and all of counsel's other points.

"Counsel arranged an adjustment of the bonuses for the year 1917 on the same relative basis as the bonuses for the year 1918, approved by the reorganized board.

"Assuming that the bonus to directors in 1917 will remain as originally agreed to, that is, on the relative basis of the 1918 bonus, the additional tax to the Government for the years 1916, 1917, and 1918 will amount to $718,770.11.

"This shows a saving to the company between the original amount claimed and what will be the final assessment of $663,507.16.

"The Government accepted the contentions presented by counsel for the company on all of the essential questions [fol. 14] that counsel for the company and the officers of the company felt were right and proper under the law and facts."

Thereafter amended returns were prepared and executed by plaintiff's executive officers, based upon the figures as agreed upon in the said conferences, and were filed with the Commissioner of Internal Revenue together with documentary evidence which it was agreed upon at the last conference should be furnished, and the tax so computed, with a slight change not material to this case, was paid by the plaintiff.

XX

The total compensation paid to the executives and members of the board of directors for the year 1918 was allowed by the Commissioner of Internal Revenue as a proper deduction for that year.

XXI

John Quinn, Hans Stoehr, Otto Kuhn, Thomas Prehn, and George Roehlig, died prior to the joinder of issue herein.

XXII

The compensation of directors and executive officers for their services on the basis of percentage of profits has for many years been the practice among many corporations engaged in the woolen manufacturing business.

XXIII

In November, 1923, the Alien Property Custodian sold to Max W. Stoehr, pursuant to Executive order, 14,910 shares of the plaintiff company. In June, 1924, he likewise sold 2,455 shares to C. F. H. Johnson, and in November, 1924, he sold 5,310 such shares to C. F. H. Johnson. All of such shares, shortly after their purchase, were acquired and be-

came the property of Botany Consolidated Mills (Inc.), a Delaware corporation.

Conclusion of Law

Upon the foregoing special findings of fact, which are made part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is not entitled to recover and that the petition should be dismissed.

Judgment is rendered against plaintiff in favor of the United States for the cost of printing the record in this case, the amount thereof to be entered by the clerk and collected by him according to law.

Opinion

Moss, Judge, delivered the opinion of the court:

In its tax return for the year 1917 plaintiff, Botany Worsted Mills, claimed as a deduction for compensation paid to its board of directors for the year 1917 the aggregate sum of $1,565,739.39 in addition to certain nominal [fol. 15] salaries paid to the members of said board. The Commissioner of Internal Revenue disallowed on this item the sum of $783,656.06, and on or about June 17, 1920, an additional assessment in the aggregate sum of $703,578.37 was made against plaintiff, which sum was paid by plaintiff on or about June 28, 1920. Of this amount $450,994.06 was attributable to the disallowance by the commissioner of the said sum of $783,656.06, being a portion of the amounts paid as compensation to its directors, and claimed as a deduction for the year 1917. On February 1, 1922, plaintiff filed with the commissioner a claim for the refund of said sum of $450,994.06, which claim was rejected. This action is for the recovery of said amount.

The tax in this case was collected under the act of September 8, 1916, 39 Stat. 756, as amended by the act of October 3, 1917, 40 Stat. 300, the applicable portion of which is as follows:

"§12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by de-

ducting from the gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, * * *."

On January 11, 1890, plaintiff incorporated in its by-laws the following provision:

"Par. 1. After the close of every half of the business year of the company a computation of profits shall be made, and if practicable a dividend not exceeding three per centum shall be paid to the stockholders.

"Par. 2. At the close of the business year the net profits shall be distributed as follows, after suitable deductions shall have been made from the value of the property of the company:

" '(1) A dividend of six per centum is to be paid to the stockholders, in the computation of which any dividend or dividends already paid to the stockholders during the same business year shall be included.

" '(2) The balance remaining is to be applied as follows:

" '(a) Five per centum shall be placed in a reserve fund until the amount of the reserve fund thus accumulated shall be equal to twenty per centum of the paid-up capital of the company for the time being.

" '(b) Twenty-five per centum is to be paid as a bonus to the board of directors.

" '(c) Seventy per centum is to be paid as additional dividend to the shareholders.'

"The board of directors may, however, with the consent of the majority of the shareholders, use a portion of the amount mentioned in the last paragraph, marked 'c' for special deductions from accounts or for the formation of a special reserve fund or for extra compensation, to be paid to employees or for any institutions which will benefit the employees, such as pension funds and the like."

The above provision remained in effect until April 11, 1903, at which time it was amended so that subdivision 2-b of paragraph 2 thereof read: "Forty per centum is to be paid as a bonus to the board of directors." In March, 1908, it was again amended so as to provide as compensation to

the directors a sum equal to "32 per centum of said bal-
[fol. 16] ance * * *." From that time until after the close of the taxable year 1917 the above provision remained in force, and annual payments during that period have continuously been made in accordance therewith. The said sum of $1,565,739.39 was a sum equal to 32 per cent of the balance of the net profits for the taxable year 1917, after the several deductions provided for in said by-laws had been made.

The Government has interposed two defenses to this action: First, it is claimed that the amount paid the directors for 1917 was unreasonable compensation; and, second, that in 1919 the various tax matters of plaintiff for 1917 were finally settled by compromise and mutual agreement.

These contentions will be considered in the order named above.

It is shown by the record that during the whole period of plaintiff's existence its executive officers have been paid as compensation in addition to certain fixed salaries a percentage of the net earnings. The board of directors determined each year the aggregate amount payable to its members in accordance with the by-laws. The distributions among its members were made by the board on the recommendation of its chairman, in conjunction with its treasurer and vice president. Each director holds a position as an executive officer, or manager, of a certain department of the business. This method of compensation was consistently followed for nearly 30 years, during which time the gross assets of plaintiff company had increased from $1,114,-149.63 in 1890, to $28,893,777.12 in 1917; and its net assets, including reserves, had increased from $37,136.35 in 1890 to $10,999,862.48 in 1917. It is also made to appear that such method of compensating directors and officers has been the practice in many corporations engaged in the woolen manufacturing business. It follows, therefore, that the payment of such compensation to the directors of this corporation for the year 1917 constituted one of the "ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties * * *." The Commissioner of Internal Revenue, under the act of 1917, did not have authority to determine whether or not

compensation paid to its officers by a corporation was unreasonable compensation, and to limit the deduction to what he might consider reasonable compensation. He did have the right to determine whether or not the amount paid as compensation or salary was in fact something else, paid under the guise of salary. In this case the Government has not claimed that any part of the payments to the directors was not compensation, as claimed by plaintiff. The contention is, that the commissioner had authority to reduce the amounts actually paid to what he considered reasonable compensation. The case of United States v. Philadelphia Knitting Mills Company, 273 Fed. 657, decided June 13, 1921, seems conclusive on this point.

The Government contends that there was no legal authority at the time of the settlement of plaintiff's taxes for the compromise of taxes between the Government and a taxpayer, except as contained in section 3229 of the Revised Statutes, which reads as follows:

"The Commissioner of Internal Revenue, with the advice and consent of the Secretary of the Treasury, may com- [fol. 17] promise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon; and, with the advice and consent of the said Secretary and the recommendation of the Attorney General, he may compromise any such case after a suit thereon has been commenced. Whenever a compromise is made in any case there shall be placed on file in the office of the commissioner the opinion of the Solicitor of Internal Revenue, or of the officer acting as such, with his reasons therefor, with a statement of the amount of tax assessed, the amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise," and that inasmuch as the procedure prescribed by this section was not adopted the agreement was invalid and unenforceable. It is not claimed by the Government that plaintiff's taxes were settled under the provisions of section 3229. The theory upon which its defense on this point is based is that an agreement was entered into between plaintiff and the Commissioner of Internal Revenue under which plaintiff accepted the partial disallowance as to compensation, and also re-

ceived certain concessions as to other disputed items, the benefit of which it still enjoys, and that, therefore, plaintiff is estopped from recovery in this action. In addition to the question of compensation there was pending at the same time and for the same year the question of depreciation and also the question of reserves charged to expenses. These items involved important amounts. All matters in dispute between plaintiff and the Government were settled, and the 1917 taxes were paid in accordance with the agreements theretofore reached in conference in the Internal Revenue Bureau. The negotiations in the bureau extended over a period of several months, involving considerable correspondence and numerous conferences.

With reference to the compensation item, it should be mentioned that on July 30, 1918, the Alien Property Custodian, holding more than two-thirds of the shares of plaintiff company, caused the by-laws with reference to the compensation feature to be amended so as to provide that the directors should thereafter receive such sum, not exceeding 32 per cent of the balance of the net profits, "as the board of directors shall in its sole discretion determine." Under the amended by-laws, and by the determination of the board, the directors received as their aggregate compensation for the year 1918 the sum of $593,416.96. In the conferences in the bureau plaintiff was represented by its counsel, John Quinn, who died before this action was instituted, and the bureau was represented by Sidney Alexander, then chief of what is called the special audit section, together with certain of his official associates. Plaintiff's counsel was advised by Alexander that in view of the fact that the new ownership, meaning the Alien Property Custodian, had considered the compensation for the year 1918 as being fair and reasonable, it was his opinion that the same conclusion "could be reached upon the part of the Government in considering it a fair and reasonable amount for 1917." This item was finally settled on that basis. From time to time throughout the progress of the negotiations in the bureau plaintiff's counsel reported to its board of directors the substance of the matters occurring in such conferences. That plaintiff derived an advantage in the [fol. 18] settlement of this controversy is shown by the min-

utes of its board of directors of date April 23, 1920, wherein the various items in dispute, all having been agreed upon in conference, were discussed. (See Finding XIX.) The following statement is made:

"This shows a saving to the company, between the original amount claimed and what will be the final assessment, of $663,507.16."

Thereafter plaintiff prepared amended returns based upon the figures theretofore agreed upon in the bureau conferences, and same were forwarded to the Commissioner of Internal Revenue, together with certain documentary evidence which it was agreed at the last conference in the bureau should be furnished. With one slight change the tax shown by the amended returns was paid.

With the payment of the tax under the circumstances surrounding this case the agreement, which is mentioned in the record as a "gentleman's agreement," became in legal effect an executed contract of settlement. Plaintiff now seeks to recover on account of the particular item, which it regards as unfavorable to its interests, and at the same time hold to the advantage derived from the settlement of other items in dispute involved in the same general settlement.

It is the opinion of the court that plaintiff should not be allowed a recovery. It is therefore adjudged that the petition herein should be, and the same is hereby, dismissed.

Graham, Judge; Hay, Judge; Booth, Judge; and Campbell, Chief Justice, concur.

[fol. 19] VI. JUDGMENT

At a Court of Claims held in the City of Washington on the 4th day of April, A. D., 1927, judgment was ordered to be entered as follows:

The Court, upon due consideration of the premises, find in favor of the defendant, and do adjudge and order that the plaintiff, as aforesaid, is not entitled to recover and shall not have and recover any sum in this action of and from the United States; and that the petition herein be and it hereby is dismissed: And it is further adjudged and ordered

that the United States have and recover of and from the plaintiff, as aforesaid, the cost of printing the record in this court. No printing having been done by the court, no costs are taxed.

VII. Proceedings After Judgment

On May 17, 1927, the plaintiff filed a motion for a new trial.

On November 7, 1927, the court entered the following order and memorandum on said motion:

Order

It is ordered by the court this 7th day of November, 1927, that the plaintiff's motion for new trial be and the same is overruled.

Memorandum

On June *June* 6, 1927, a brief was filed herein by Holmes, Brewster & Ivins as amicus curiæ, in which it is alleged that the question of plaintiff's tax for the year 1918 is now pending and undetermined, and that "the opinion of the court implies an application of that decision to the tax liability of the plaintiff for 1918 as a binding precedent, whereas, to the contrary, no facts were presented in issue to this court with respect to the year 1918." We do not believe that the question of plaintiff's tax liability for any year other than the year 1917 is affected by the decision in this case.

[fol. 20] Clerk's certificate to foregoing transcript omitted in printing.

Endorsed on cover: File No. 33,111. Court of Claims, Term No. 659. Botany Worsted Mills, petitioner, vs. The United States. Petition for writ of certiorari and exhibit thereto. Filed December 22nd, 1927. File No. 33,111.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed February 27, 1928

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILED
APR 9 1928
CHARLES ELMORE CROPL
CLERK

Supreme Court of the United States

OCTOBER TERM, 1927.

No. 31

BOTANY WORSTED MILLS,
Petitioner,

vs.

THE UNITED STATES.

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

BRIEF FOR PETITIONER.

NATHAN A. SMYTH,
Counsel for Petitioner.

PRINTED IN THE UNITED STATES BY C. G. BURGOYNE, INC., 107 LIBERTY STREET, NEW YORK

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SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1927.

No. 659.

BOTANY WORSTED MILLS,
Petitioner,

vs.

THE UNITED STATES.

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

BRIEF FOR PETITIONER.

The opinion of the Court of Claims has not yet been reported.

The judgment under review was entered April 4, 1927 (R. 26). The jurisdiction of this court is invoked under the Act of February 13, 1925, Sec. 3, paragraphs (b) and (c).

STATEMENT OF THE CASE.

The Question at Issue.

The question raised on this appeal is whether an oral "gentleman's agreement" compromising differences between the Bureau of Internal Revenue and a taxpayer, made by subordinate officials of the Bureau without securing the advice and consent of the Secretary of the Treasury required by the statute authorizing the compromise of tax cases, becomes, upon the filing of amended returns and payment of an additional assessment in ac-

cordance with the figures thus agreed upon, "in legal effect an executed contract of settlement" barring recovery of a part of the tax which was erroneously and illegally collected.

The Statutes.

The only statute in effect at the time in question, authorizing any compromise of tax cases, was Sec. 3229 of the Revised Statutes, which reads as follows:

> "The Commissioner of Internal Revenue, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon; and, with the advice and consent of the said Secretary and the recommendation of the Attorney General, he may compromise any such case after a suit thereon has been commenced. Whenever a compromise is made in any case there shall be placed on file in the office of the Commissioner the opinion of the Solicitor of Internal Revenue, or of the officer acting as such, with his reasons therefor, with a statement of the amount of tax assessed, the amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise."

The making of contracts on behalf of the United States except as authorized by law is prohibited under Sec. 3732 of the Revised Statutes, which reads as follows:

> "No contract or purchase on behalf of the United States shall be made, unless the same is authorized by law or is under an appropriation adequate to its fulfillment, except in the War and Navy Departments, for clothing, subsistence, forage, fuel, quarters, or transportation, which, however, shall not exceed the necessities of the current year."

The Facts.

Under a by-law which was originally adopted by the petitioner's stockholders in 1890 (R. 12) and, with slight modifications made by the stockholders, was in effect during 1917 (R. 13-15), the directors of petitioner, each of whom was an executive officer or manager of a department in the company (Finding XIV, R. 16), were entitled to receive compensation equal in the aggregate to 32% of the balance of the net profits of the company after certain deductions (Findings X, R. 14; see also R. 15.)

The net income of the company for 1917 was proportionately very large (R. 17). In its tax return for that year the company deducted as an expense the sum of $1,565,739.39 paid to its directors under such by-law (Finding III, R. 11).

Thereafter, in the year 1919, the Commissioner of Internal Revenue proposed making an additional assessment against petitioner for the year 1917. This necessitated the settlement of questions relating to the compensation paid to the directors and also to excessive depreciation charged off on the books of the company and reserves charged to expenses (Finding XIX, R. 18). After much correspondence and numerous conferences, extending over several months, in which the petitioner was represented by its attorney and assistant treasurer and others, and the Government by the chief of the special audit section of the Bureau of Internal Revenue and others of his official associates, "a compromise was agreed to as to all of the differences" (R. 19).

The compromise was based on the statement by the Bureau's representative that the amount of the compensation paid to the directors of the company for the year 1918 (while the company was controlled by the Alien Property Custodian, see R. 15) would be considered as a fair and reasonable amount for 1917 (R. 19). Accordingly, the Commissioner disallowed $783,656.06 of the deductions which had been taken for such compensation

in 1917 and allowed the balance "on the ground that the amounts paid as compensation were unreasonable, and that the deductions allowed represented fair and reasonable compensation" (Finding IV, R. 11). No concession is shown to have been made by the Bureau with reference to the other two questions involved relating to the 1917 taxes.

Thereafter the petitioner filed amended returns based on the figures as agreed upon in the conferences, together with documentary evidence which, at the last conference, it was agreed should be furnished, and the tax so computed, "with a slight change not material to this case" was paid by the petitioner. (Finding XIX, R. 20.) As a result of the disallowances made by the Commissioner, the petitioner was assessed and paid an additional tax of $703,578.37 for 1917, of which amount $450,994.06 was attributable to the disallowance of the said portion of the amount paid to the directors (Finding IV, R. 11). On February 1, 1922, the petitioner filed with the Commissioner of Internal Revenue a claim for refund of the said sum of $450,994.06. This was disallowed by the Commissioner on or about September 26, 1922 (Finding V, R. 12).

The Pleadings.

On September 12, 1924, the petitioner filed its petition in the Court of Claims of the United States asking judgment for the said amount of $450,994.06, with interest from June 28, 1920, allowable under Sections 1019 and 1020 of the Revenue Act of 1924 (R. 6 and 9).

The defendant entered no demurrer, plea, answer, counterclaim, setoff, claim of damages, demand, or defense and, consequently, a general traverse was entered as provided by Rule 34 of the Court of Claims (R. 9).

The Decision of the Court of Claims.

On the trial the Government interposed, under its general traverse, two defenses; first, "that the amount paid the directors for 1917 was unreasonable compensation; and, second, that in 1919 the various tax matters of plaintiff for 1917 were finally settled by compromise and mutual agreement." (Opinion R. 23.)

According to its opinion (no specific conclusions of law having been filed), the Court of Claims held that the directors' compensation "constituted one of 'the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties' " by the company and was therefore deductible (Revenue Act of 1916, Sec. 12(a)) (R. 23). It held also that, under that Act, the Commissioner of Internal Revenue, while having "the right to determine whether or not the amount paid the directors as compensation or salary was in fact something else, paid under the guise of salary," nevertheless "did not have authority to determine whether or not the compensation paid to its officers by a corporation was unreasonable compensation and to limit the deduction to what he might consider reasonable compensation." (R. 23, 24.) Inasmuch as "the Government has not claimed that any part of the payments to the directors was not compensation," the court, following the decision of the Circuit Court of Appeals of the 3d Circuit in *U. S.* v. *Philadelphia Knitting Mills Co.*, 273 Fed. 657, held with the petitioner on the main issue as to the illegality of the tax (R. 24).

The Court of Claims, however, denied petitioner any recovery on the basis of the second defense, holding, according to the opinion, that although "it is not claimed by the Government that plaintiff's taxes were settled under the provisions of section 3229" (R. 24), nevertheless "with the payment of the tax under the circumstances surrounding this case the agreement, which is mentioned in the record as a 'gentleman's agreement'

became in legal effect an executed contract of settlement" (R. 26).

Judgment accordingly was entered against the plaintiff on the 4th day of April, 1927 (R. 26). On May 17, 1927, plaintiff filed a motion for a new trial, which was denied, without opinion, on the 7th of November, 1927 (R. 26-27).

The petition for a writ of certiorari addressed to this court was granted on the 27th day of February, 1928.

SPECIFICATIONS OF ERROR.

Petitioner claims that the Court of Claims erred,

First, in holding that a contract of settlement could have been effected otherwise than with the advice and consent of the Secretary of the Treasury required by Section 3229 of the Revised Statutes; and

Second, in refusing to accord to petitioner the right to recover a tax erroneously or illegally collected which is granted by the provisions of the Revenue Act of 1924 which govern this action.

THE ARGUMENT.

POINT I.

The advice and consent of the Secretary of the Treasury was a necessary condition precedent to any valid compromise agreement between the Commissioner of Internal Revenue and a taxpayer.

A.

The only authority to enter into agreements compromising tax cases which had been given to the Commissioner of Internal Revenue at the time in question

(1919) was conferred by Sec. 3229 of the Revised Statutes, quoted above (p. 2).

It is conceded that the provisions of Section 3229 were not complied with (R. 24).

When Congress granted authority to the Commissioner to comprise tax cases under specific limitations, it negatived his authority to effect a compromise in any other way.

In *Raleigh Co.* v. *Reid,* 13 Wall. 269, this court said:

> "When a statute limits a thing to be done in a particular mode, it includes a negative of any other mode."

In the case of *Little et al.* v. *Barreme,* 2 Cranch. 170, an officer of the United States Navy, while the United States was at war with France, acting pursuant to instructions given under the authority of a proclamation by the President, captured the Danish brigantine, "Flying Fish". The owners thereafter claimed damages against the officer. He interposed as a defense the instructions he had received under the President's proclamation. The proclamation had been issued following the passage of an Act of Congress authorizing the seizure of American vessels suspected of being engaged in illicit commerce, bound, or sailing to any port or place in France. The proclamation had authorized the seizure of a vessel thus suspected, bound to or from French ports. The vessel in question had been coming from a French port.

Chief Justice Marshall, in writing for this court, said that, while it was "by no means clear that the President of the United States * * * might not without any especial authority for that purpose have authorized a seizure under the facts in question," nevertheless, inasmuch as the Act gives special authority to seize on the high seas, "and limits that authority to the seizure of vessels bound, or sailing to, a French port, the legislature seems to have prescribed that the manner in which

this law shall be carried into execution, was to exclude a seizure of any vessel not bound to a French port."

In *The United States* v. *George Jonas,* 19 Wall. 598, this court considered the effect of a statute which authorized the Solicitor of the Treasury to sell certain lands of the United States with the approval of the Secretary of the Treasury. The Solicitor, pursuant to an advertised sale, had tendered a deed to the highest bidder who refused to take it on the ground that there was no evidence that the consent and approval of the Secretary of the Treasury had been secured. This court held that the approval was "a thing essential to give validity to the sale" and "a condition precedent, without which the Solicitor has no authority whatever to act."

In the leading case of *The Floyd Acceptances,* 7 Wall. 666, this court said:

> "We have no officers in this government, from the President down to the most subordinate agent, who does not hold office under the law, with prescribed duties and limited authority."

The opinion referred "to the written law as the exclusive source of such authority."

In the instant case, the so-called compromise agreement, not having been authorized by law, falls within the specific prohibition of Sec. 3732 of the Revised Statutes (*supra* p. 2) and, accordingly, was null and void.

In *Whiteside* v. *U. S.,* 93 U. S. 247, a contract was attempted to be made pursuant to regulations issued by the Treasury Department under statutory authority. Such regulations required the approval of contracts of the kind in question by the supervising special agent. The contract under consideration, not having received such approval, this court said:

> "Tested by these several considerations, it is obvious that the conclusion of the court below, that the contract was incomplete because not approved

> by the supervising special agent, is correct. Beyond all doubt, it was made by the assistant special agent, who had no authority to make it; and it appearing that it never was approved by the supervising special agent, it follows that it was *null and void.*" (Italics ours.)

In *Filor* v. *U. S.*, 9 Wall. 45, this court considered a lease which had been made by an Assistant Quartermaster of a wharf that had been seized by the officers of the United States Army. It was found that, under the existing regulations, no lease could be binding upon the Government until approved by the Quartermaster General. Such approval had not been had. The court said:

> "The agreement or lease was, so far as the Government is concerned, the work of strangers."

In *Leach* v. *Nichols,* 23 Fed. (2d) Advance Sheets 275 (C. C. A. 1st Circuit) it was held that a compromise agreement made with the Internal Revenue Bureau without the advice and consent of the Secretary of the Treasury was not authorized, because failing to comply with R. S. Sec. 3229, and could not bar the taxpayer from maintaining an action in the courts.

B.

Under the then existing Treasury Regulations and in view of the established practice of the Internal Revenue Bureau, the "gentleman's agreement" must be construed as leaving it open to either party to take such further proceedings as might be authorized by law.

Article 38 of the Treasury Regulations relating to the Act of 1917 (Regs. No. 38 Revised), then in effect, provided that

> "Treasury decisions promulgating rulings of the Internal Revenue Bureau become effective upon the date of approval unless otherwise stated therein. Cases previously adjusted in contravention of

law as pronounced in such decisions, are subject to readjustment in accordance with the decision."

The transactions between the petitioner and the Internal Revenue Bureau were necessarily subject to this regulation. Under its provisions no adjustment could be made which might not be reopened in case of a subsequent change in ruling as to the law.

Commenting on the situation created by this regulation, the Senate Finance Committee, in reporting the Act of 1921 (see Senate Report 275 of Sep. 26, 1921, p. 31), stated with reference to the proposed Sec. 1312 thereof:

> "Section 1312 authorizes the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury and with the consent of the taxpayer, to reach a final settlement in tax cases which shall not be reopened or modified by any officer, employee, or agent of the United States, and which shall not be annulled or set aside by any court of the United States.
>
> "Under the present method of procedure a taxpayer never knows when he is through, as a tax case may be opened at any time because of a change in ruling by the Treasury Department. It is believed that this provision will tend to promote expedition in the handling of tax cases and certainty in tax adjustment. Your committee, therefore, recommends its adoption."

Sec. 1312 of the Act of 1921, referred to in such report, reads as follows:

> "Sec. 1312. *Final determinations and assessments.*—That if after a determination and assessment in any case the taxpayer has without protest paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is made in writing between the taxpayer and the Commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of

> fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States."

The long continued practice of the Bureau and its own interpretation of the Commissioner's authority are evidenced by the following decisions of the Income Tax Unit and the Board of Tax Appeals:

In Cumulative Bulletin III-1 (January-June, 1924) at pages 338-339 is printed a ruling by the Income Tax Unit in which, after referring to the existing statutes relating to the powers of the Commissioner to make assessments, it is said:

> "Under the above sections of the law the Commissioner is specifically authorized to make inquiries, determinations, and assessments of taxes accruing under the various internal revenue laws. There is no provision of law which would prohibit the Commissioner from making reexaminations of income returns as often as he desires, unless he enters into a written agreement that the determination and assessment already made shall be final. The provisions of section 1312 specifically recognize that unless and until an agreement is made in writing between the Commissioner and the taxpayer closing the case it may be reexamined and the tax redetermined and additional assessments made as often as the Commissioner deems advisable within the prescribed time. If such was not the case, section 1312 would be unnecessary.
>
> * * * * * * * * *
>
> "This office has always taken the position that the Commissioner may assess any tax found to be due even though said tax may have previously been abated or refunded, provided such assessment is made within the time prescribed by statute. If there is a willful attempt to defeat or evade the

> tax, the assessment may be made at any time. Section 1322 of the Revenue Act of 1921."

In the case of *Dallas Brass & Copper Company,* Decision No. 1279, Board of Tax Appeals, (decided February 18, 1926) the taxpayer had made application for relief from certain assessments and the Commissioner had granted an abatement of the tax. Further application had been followed by numerous conferences, as a result of which the Commissioner allowed a further reduction which was embodied in writing. The amount as thus reduced was fully paid by the taxpayer. The decision was that the Commissioner was entirely free to reopen the case after the final payment, the opinion stating:

> "It has long been recognized, both by the Commissioner and all of his predecessors, as well as taxpayers generally, that reconsiderations of liability to internal revenue taxes were both proper and lawful."

That the views of the limitations upon its own authority finally to bind the Government which have been uniformly acted upon for years by the Bureau of Internal Revenue, should not be disregarded, is shown by the decision of this Court in *United States* v. *Finnell,* 185 U. S. 236, 244, where it is said:

> "If the construction thus acted upon by accounting officers for so many years should be overthrown, we apprehend that much confusion might arise. Of course, if the departmental construction of the statute in question were obviously or clearly wrong, it would be the duty of the court to so adjudge. *United States* v. *Graham,* 110 U. S. 219, 28 L. ed. 126, 3 Sup. Ct. Rep. 582; *Wisconsin C. R. Co.* v. *United States,* 164 U. S. 190, 41 L. ed. 399, 17 Sup. Ct. Rep. 45. But if there simply be doubt as to the soundness of that construction,—and that is the utmost that can be asserted by the government,—the action during many years of the Department charged with the execution of the statute should be respected, and not overruled except for cogent reasons. *Edwards* v.

Darby, 12 Wheat. 206, 210, 6 L. ed. 603, 604; *United States* v. *Philbrick*, 120 U. S. 52, 59, 30 L. ed. 559, 7 Sup. Ct. Rep. 413; *United States* v. *Johnston*, 124 U. S. 236, 253, 31 L. ed. 389, 8 Sup. Ct. Rep. 446; *United States* v. *Alabama G. S. R. Co.*, 142 U. S. 615, 621, 35 L. ed. 1134, 12 Sup. Ct. Rep. 306. Congress can enact such legislation as may be necessary to change the existing practice, if it deems that course conducive to the public interests."

C.

The opinion of the Court of Claims refers to a contention which had been advanced before it by the Government that the plaintiff "is estopped from recovery in this action" because it "received certain concessions as to other disputed items" (R. 25). The Solicitor General, however, in his brief on the petition for a writ, conceded that "no ground to claim estoppel is disclosed in the findings" (Brief for U. S. p. 11). Of this there can be no question.

The findings do not show that the plaintiff derived any benefits whatsoever in the alleged compromise other than the concession to it of an allowance of part of the directors' compensation, all of which should have been allowed. The inclusion in Finding XIX (R. 19 and see Opinion R. 25-26) of an excerpt from the minutes of plaintiff's board of directors is a finding of evidence, contrary to Rule 38 of this court, and may not be relied upon to support the decision. See *Norris* v. *Jackson*, 9 Wall. 125, *Raimond* v. *Terrebonne Parish*, 132 U. S. 192, 194 and *The E. A. Packer*, 140 U. S. 360, 365. Furthermore, it is obvious that, as a matter of logical inference, these minutes, which indicate a combined saving to the petitioner from additional assessments originally proposed for the three years, 1916, 1917 and 1918 (R. 19-20), do not throw any light whatsoever on how much of that saving was effected by the compromise of the 1917 taxes.

The only principle of estoppel which seems in any way to have been relied upon by the Court of Claims, according to its opinion, is that a party to a contract may not

seek to disaffirm it in part while affirming it in other respects (R. 26). This, of course, presupposes either the existence or the assertion of a contract. The petitioner has never in any way asserted the existence of a contract, but has denied it throughout.

Any defense of estoppel was waived because it was not pleaded. See *Gilmer* v. *Poindexter*, 10 Howard 257, 268, *Philadelphia W. & B. R. R. Co.* v. *Howard*, 13 Howard 307, 335; *Marbury* v. *Louisville & J. Ferry Co.*, 60 Fed. 645, 656; *Johnson* v. *Garner*, 233 Fed. 756, 773; *Feick* v. *Stephens*, 250 Fed. 185, 190 and *Krekeler* v. *Ritter*, 62 N. Y. 372, 374.

The transactions between the plaintiff and the Bureau of Internal Revenue could not have estopped one of the parties from pursuing any rights to question the validity of the tax granted it by statute unless they could have estopped the other. That the Government could not be estopped by the unauthorized actions of its agents is clear. See *Filor* v. *U. S.*, 9 Wall. 45, and *Utah Power and L. Co.* v. *U. S.*, 243 U. S. 389, 409. The principle stated by Judge Peckham in *Myers* v. *Cronk*, 113 N. Y. 608, 613, that "not being bound by any estoppel himself, he can claim the benefits of none, for it is familiar that estoppels, to be binding, must be mutual", applies here with full force.

POINT II.

Any right which the United States might once have had to set up the informal agreement and petitioner's action pursuant thereto as a bar to recovery was waived by the Revenue Act of 1924, under the provisions of which this action was brought.

Prior to 1924, the payment of the tax by the petitioner without protest and pursuant to the informal compromise might possibly have been construed as voluntary, thus barring an action for its recovery. (See *Fox* v. *Edwards*, 287 Fed. 669.)

This action was brought under Section 1014 of the Revenue Act of 1924 which reads as follows:

> "Sec. 1014. (a) Section 3226 of the Revised Statutes, is amended to read as follows:
>
> " 'Sec. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof; *but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress.* No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of five years from the date of the payment of such tax, penalty, or sum, unless such suit or proceeding is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates. The Commissioner shall within 90 days after any such disallowance notify the taxpayer thereof by mail.'
>
> "(b) This section shall not affect any proceeding in court instituted prior to the enactment of this Act". (Italics ours.)

Paragraph (b) makes it clear that the provisions of paragraph (a) apply to cases where court proceedings are instituted subsequent to the enactment of the Act, which was signed on June 2, 1924. This action was instituted September 12, 1924 (R. 6). Accordingly, the fact that the tax was paid without protest or duress can constitute no defense to the action.

To provide a method for finally determining a tax case without litigation, (See the Senate Report above quoted at p. 10), Sec. 1312 of the Act of 1921 was substantially reenacted in the following section of the 1924 Act:

> "Sec. 1006. If after a determination and assessment in any case the taxpayer has paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is made in writing between the taxpayer and the Commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States."

By these two Sections (1014 and 1006), Congress specifically decreed what conduct on the part of a taxpayer would debar him from recovering through the courts a tax illegally collected. A failure to file a claim for refund with the Commissioner of Internal Revenue, or to bring suit, within the times limited under Sec. 1014, or the making of an agreement as provided in Sec. 1006 would work such result. An agreement made in accordance with the provisions of Sec. 3229, Rev. Stat. (*supra* p. 2), which was not repealed by the Act of 1924, would also constitute a bar.

In this case there was a determination and an assessment paid in whole by the taxpayer based thereon, (Finding IV, R. 11) as specified in Sec. 1006; but there was no subsequent agreement as provided for therein. The expression in the statute of a particular form of

agreement as constituting a bar to an action in any court excludes any other kind of agreement from so operating.

Section 1006 gives protection to both the Government and the taxpayer. It would seem clear that Congress intended that no agreement made otherwise than as provided either by this section or by Sec. 3229 should preclude the Government from reopening a case or the taxpayer from bringing suit. If any such informal arrangement as was made in the instant case may become effective as a legally executed settlement contract, the efforts of Congress to safeguard the interests of the Government and the rights of taxpayers to appeal to the courts will be rendered nugatory.

POINT III.

If this court reverses the Court of Claims, the findings of that court are such as to justify the direction of a money judgment in behalf of the petitioner.

In the memorandum presented by the Solicitor General upon the petition for a writ herein, it was intimated that he might ultimately take the position that, in case of a reversal, the direction of a judgment for any stated sum is not justified by the findings. He pointed out two respects in which he considered the findings deficient, but in each case overlooked certain findings.

A. As to whether the payments to the directors were in fact compensation.

The Solicitor General stated that "in its opinion, but not in its findings the Court of Claims, said 'each director holds a position as an executive officer, or manager, of a certain department of the business'" (p. 14). This fact, however, is set forth in Finding XIV (R. 16).

The Solicitor General also overlooked the fact that Finding IV (R. 11) shows that the disallowance of a part of the directors' compensation was made by the Bureau "on the ground that the amounts paid as compensation were unreasonable."

He overlooked also, the fact, stated in the opinion that "the Government has not claimed that any part of the payment to the directors was not compensation, as claimed by plaintiff" (R. 24). The defense was only that it was "unreasonable compensation" (R. 23).

The findings that the compensation was paid in accordance with the by-laws of the company dating back to 1890 (Finding III, R. 11, Finding VII, R. 12, Finding X, R. 14) and with a custom prevailing in the industry (Finding XXII, R. 20), together with the finding that the only contract with any of the directors as to compensation was that implied from his election to and acceptance of membership on the board and his service as such member in accordance with the by-laws and practices of the company, which were known to each director (Finding XIV, R. 16), conclusively demonstrate that here was a contractual obligation, the payment of which, as stated by the court below in its opinion "constituted one of the 'ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties'" (R. 23). It was consequently deductible under Sec. 12 (a) of the Revenue Act of 1916 which provides for the deduction of

> "All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity."

It was not until the Revenue Act of 1918 that permissible deductions of amounts paid as salaries were limited to a "reasonable allowance" (see Revenue Act 1918, Sec. 234 (a) (1)).

All of the facts bearing on this aspect of the case were stipulated by the parties. While the stipulation is not in the record, we feel certain that the Solicitor General, in loyalty to it, will not again intimate to this court that there may be any question as to the fact that there was no relation between the amounts of stock held by the directors and the amounts they received as a percentage of profits.

B. As to possible offsets or counterclaims.

It should be noted that the Government, in its pleadings, as shown by the record before this court, did not assert any counterclaim, setoff or demand of any sort (R. 9).

In his memorandum on the petition for a writ herein, the Solicitor General, in two instances, misapprehended the findings relating to the concession made by the Government in the compromise. He asserted that "the items of depreciation and reserves claimed by the petitioner were allowed" (p. 7) and again that "the Bureau of Internal Revenue acquiesced in the petitioner's claims respecting depreciation and reserves for the same year, 1917" (p. 11). Neither of these statements has any support in the findings of the Court of Claims and neither is correct.

The only concession made to the petitioner in the compromise agreement shown by the findings was that involved in allowing approximately one-half of the deduction for directors' compensation.

We respectfully urge that unless the Solicitor General—after having made an examination of the facts

stipulated by the Government herein, which are not consistent with his suggestion that any concession other than as to directors' compensation was made by the Bureau in the compromise—will inform this court that, in case of reversal, the Government intends in good faith to interpose some definite offset in the court below, there is no reason why the petitioner should be subjected to the expense and delay of further court proceedings or why a judgment should not be directed for the sum of $450,994.06 with interest at 6% from June 28, 1920 as claimed in the petition (R. 9).

Respectfully submitted,

NATHAN A. SMYTH,
Counsel for Petitioner.

FILED
OCT 20 1928
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM, 1927.

No. [redacted] 31

BOTANY WORSTED MILLS,
Petitioner,

vs.

THE UNITED STATES.

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

REPLY BRIEF FOR PETITIONER.

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Counsel for Petitioner.

Printed in the United States by C. G. Rudcovsk, Inc., 107 Liberty Street, New York

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1927.

No. 659.

BOTANY WORSTED MILLS, *Petitioner,* *vs.* THE UNITED STATES.	ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

REPLY BRIEF FOR PETITIONER.

A. IN RESPONSE TO THE BRIEF SUBMITTED *Amicus Curiae.*

The argument contained in the brief *amicus curiae*, filed herein, is predicated on an assumption of fact which has no support in the findings of the Court of Claims.

Such assumption is that in the informal settlement the petitioner gained, and seeks to retain, certain advantages conceded to it in the adjustment of the two questions involved other than that of directors' compensation. Proceeding upon this assumption the brief argues that, inasmuch as the petitioner cannot now be divested of such advantages because of the running against the Government of the Statute of Limitations, it should not be permitted to recover.

The authors of the brief frankly state that they have relied for their facts on the briefs submitted in behalf of the defendant in the Court of Claims. Such view of the facts is not supported by the findings. The Solicitor

General concedes that the findings do not disclose a ground for estoppel. (Government's brief, p. 12.)

What the findings do disclose is that three questions were in issue (Finding XIX, R. 18), that a compromise was agreed to as to all of the differences, and that the allowance for directors' compensation was adjusted on the basis of the amount paid in 1918 (R. 19). There is no finding, direct or implied, that petitioner received any concession as to the other two questions. On the contrary it appears that, as a result of the negotiations, an additional assessment was made for the year 1917 of $703,578.37 of which only $450,994.06 was attributable to the disallowance on account of directors' compensation (Finding IV, R. 11).

Thus, it appears that both the brief *amicus curiae* and that of the Solicitor General (p. 12) are in error in assuming that the representatives of the Bureau of Internal Revenue acquiesced in the petitioner's claims as to the other two questions involved. That such cannot be the case is clear from the fact that additional assessments of $252,584.31 were imposed upon the petitioner with respect to the other items in dispute.

The contention in the brief *amicus curiae* that the defendant was precluded by the Statute of Limitations from claiming any offsets against the petitioner, is not made by the Solicitor General who asserts correctly (see brief for U. S., pp. 12-13) that if the adjustment was not conclusive, the Government, on a judicial inquiry as to the correctness of the 1917 tax, is in as good a position as it ever was to question all deductions. The Court of Claims, in the exercise of its equitable jurisdiction, (See *U. S.* v. *Milliken Imprinting Co.*, 202 U. S. 168) is not precluded by the running of any Statute of Limitations from directing, as a condition of recovery, allowance of any claims which should properly be offset against it. (See *Talbot* v. *Hill*, 261 Fed. 244, 245-6; *People* v. *Freeman*, 110 App. Div. (N. Y.) 605, 608; *De Walsh* v. *Bra-*

man, 160 Ill. 415.) Furthermore, it appears from the findings that petitioner made its claim for a refund of the tax in question on February 1, 1922 (R. 12) while the statutory time within which additional assessments might be made did not expire until March 15, 1923. The Commissioner, therefore, had more than a year, after being put on notice that petitioner was resorting to its statutory remedies for a review of the 1917 tax, within which to make additional assessments if he believed any to be justified. His inaction during that year should not work to estop the petitioner. The authors of the brief *amicus curiae* are apparently unaware that a formal waiver of the Statute of Limitations was filed by petitioner in the Court of Claims.

The brief *amicus curiae* contributes nothing new to the law of this case. In the cases of *The Lone Star Brewing Association* v. *U. S.*, 61 Ct. Cls. 118, *Walker* v. *Alamo Foods Co.*, 16 Fed. (2d) 694, and *Rau* v. *U. S.*, 260 Fed. 131, cited at pages 18-21 of the brief, there had been a written agreement made pursuant to the provisions of Sec. 3229 R. S. This is conceded at page 22 of the brief.

To support the contention that the right and power exist to compromise such matters without reference to the statutory authority conferred under Sec. 3229, are cited, at pages 23 and 24 of the brief *amicus curiae*, the cases of *Mason* v. *U. S.*, 17 Wall. 67, *Sweeney* v. *U. S.*, 17 Wall. 75 and *Savage, Exec.* v. *U. S.*, 92 U. S. 382.

In the *Savage* case the opinion states that

> "Parties having claims against the United States which are disputed *by the officers authorized to adjust them* may compromise the claims," etc. (p. 388. Italics ours.)

This qualification that the compromise must be by officers authorized to adjust the claims is expressly recognized in each of the other two cases.

The decisions of this court, cited at page 18 of the brief, to wit: *McLean* v. *Clapp,* 141 U. S. 429, and *Grymes* v. *Sanders,* 93 U. S. 55, deal with the principles governing actions for rescission of contracts for fraud or mistake. They have no bearing on the issues here in controversy.

The contentions of the brief that the acts of the Commissioner, "within the scope of his authority, must be considered the official acts of the Secretary of the Treasury" (p. 48) and that having general authority he "is not required to find express statutory authority for all his acts in order to establish their validity or binding force" (p. 50) have no cogency in the face of the provisions of Sec. 3229 R. S. giving the Commissioner express authority to make compromises "with the advice and consent of the Secretary of the Treasury".

The argument set forth at pages 51-57 of the brief *amicus curiae* entirely overlooks the well established principle that the Government cannot be estopped by the unauthorized actions of its agents. (See p. 14 of Petitioner's main brief.) Whether or not an estoppel arises depends in the main upon the facts of the particular case. Without detailed reference to the many decisions cited in the pages of the brief above referred to, it seems to us obvious that they furnish no parallel with the facts in this case as found by the Court of Claims, upon which no estoppel can be predicated.

B. Concerning the Sufficiency of the Findings to Warrant a Final Determination by this Court.

In contending that the findings of the Court of Claims are not sufficient to sustain a decision that the amounts paid to the directors for 1917 were "ordinary and necessary expenses" and therefore deductible by the petitioner under the 1916 Act (quoted at p. 18 of our main brief), the Solicitor General entirely overlooks the fact

that such compensation was paid pursuant to a contract enforceable against the corporation and was, consequently, a necessary expenditure.

That it was also an ordinary expense is shown by two facts set forth in the findings. The first is that this method of compensation had been in existence in the corporation since the year 1890 (R. 12-14). It was ordinary to the corporation. Second, the method of compensating directors and executives on a basis of a percentage of profits had for many years been the practice of many corporations in the woolen manufacturing business (R. 20). Thus, it was, also, ordinary in the business as a whole.

While the total amount of the compensation paid to the ten directors in the year 1917 of $1,565,739.39 was extraordinarily large, it appears from Finding XIV (R. 17) that the average amount paid to the directors for the eight years 1910-1917 was approximately $459,000, which is some $134,000 less than the Commissioner considered reasonable for the year 1918 for an almost entirely new board (Findings XV, R. 17, XX, R. 20, and XI, R. 15). Directors and executives who serve for compensation contingent on success have to take the lean years with the fat. Their compensation, as thus averaged, was not extraordinary in a business enterprise of the magnitude of the Botany Worsted Mills. While we do not conceive that the question of whether the stockholders acted wisely or not, in providing for such method of remunerating those whom they put in charge of their business, is at issue, the finding which shows the increases in the net income of the business (R. 17) sufficiently demonstrates the practical wisdom and reasonableness of their policy.

The reasoning of the Circuit Court of Appeals for the Third Circuit in the opinion in *U. S.* v. *Philadelphia Knitting Mills Co.*, 273 Fed. 657, seems to us so conclusive that we can add nothing to it. The case was cited

as authoritative by the Circuit Court of Appeals for the Second Circuit in *Becker Bros.* v. *United States*, 7 Fed. (2d) 3, 6, 7. Under the facts as stated in the opinion in the *Knitting Mills* case certain salaries had been paid as determined by the board of directors and not pursuant to any contract providing for compensation. It was, therefore, in that case, an open question whether the amounts paid really represented salaries or a distribution of profits under the guise of compensation. The court held that to overcome the "presumption arising from the action of the board of directors that it was all salary" the burden was on the Government to produce evidence, not necessarily conclusive, but sufficient to raise a valid inference that some definite part of the compensation was not salary but was profits". In our case the findings show that the partial disallowance of the deduction was "on the ground that the amounts paid *as compensation* were" unreasonable. (Finding IV, R. 11.) The opinion states that "the Government has not claimed that any part of the payments to the directors was not compensation". (R. 24.) The defendant has not even attempted to meet the burden of proof. On the other hand, the findings show that the payments to the directors were made under and pursuant to a by-law directing such payment as "a compensation" (Finding XI, R. 14). The fact that this phrase originated as far back as the by-law adopted in 1905 (Finding IX, R. 13), precludes the possibility that it was devised as a method of disguising, for income tax purposes, a distribution of profits.

It is respectfully submitted that none of the suggested additional findings as to the extent and value of the services rendered by the directors, the basis of the distribution among them of the total compensation, or as to their other relations to the corporation or the amount of stock held by each could in any way affect the conclu-

sions which follow as a matter of law from the findings that have already been made by the Court of Claims.

The 1916 Act permitted the petitioner to deduct all the necessary and ordinary expenses paid by it in the maintenance and operation of its business. No special mention was made of salaries or compensation of officers and directors and there is, therefore, no statutory authority for differentiating such expenditures from any other. The court below has found facts which show that there was an implied contract with each of the directors to pay him for his services in accordance with the by-laws and customary practices of the company (Finding XIV, R. 16), and that the compensation was paid in accordance with the by-laws (Finding III, R. 11). They show also that the distribution among the directors was made in accordance with the ordinary practices of the company (Finding XIII, R. 16) and also, as we have pointed out above, that the method of compensation was an expense ordinary both to the conduct of petitioner's business and in the woolen industry as a whole. In accordance with such findings the petitioner was entitled, under the statute, to deduct such expenditure in arriving at the amount of its net income.

Respectfully submitted,

NATHAN A. SMYTH,
Counsel for Petitioner.

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In the Supreme Court of the United States

OCTOBER TERM, 1927

No. 659

BOTANY WORSTED MILLS, PETITIONER

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 21) is reported in 63 C. Cls. 405.

JURISDICTION

The judgment sought to be reviewed was entered April 4, 1927. (R. 26.) The petitioner seasonably filed a motion for new trial, which was entertained and overruled November 7, 1927. (R. 27.) The petition for certiorari was filed December 22, 1927 (R. 27) and granted without opposition from the United States. The jurisdiction of this Court rests on the Act of February 13, 1925.

THE QUESTION PRESENTED

The question presented is whether an adjustment, made in 1920, of a taxpayer's income tax liability for the year 1917, resulting from mutual concessions by the taxpayer and the representatives of the Bureau of Internal Revenue, put into effect by the making of an amended return and the payment of the tax assessed upon it, operates as an executed contract of settlement binding the taxpayer and precluding him from maintaining a suit for taxes erroneously or illegally assessed and collected, where there has been no compromise or conclusive agreement made in accordance with the provisions of the statute authorizing them.

If the question above stated is answered in the negative, the remaining question is whether the findings of the Court of Claims are sufficient and complete enough to justify this Court in directing the entry of a judgment for the petitioner for a stated sum, or whether the case should be remanded to the Court of Claims for further evidence or findings as to the nature of the payments made to the petitioner's directors and as to whether they were ordinary and necessary expenses of the corporation, deductible in computing taxable income.

THE STATUTES

Section 3229, Revised Statutes (U. S. C. Title 26, Sec. 158), is as follows:

> The Commissioner of Internal Revenue, with the advice and consent of the Secretary

> of the Treasury, may compromise any civil or criminal case arising under the internal-revenue laws instead of commencing suit thereon; and, with the advice and consent of the said Secretary and the recommendation of the Attorney General, he may compromise any such case after a suit thereon has been commenced. Whenever a compromise is made in any case there shall be placed on file in the office of the Commissioner the opinion of the Solicitor of Internal Revenue, or of the officer acting as such, with his reasons therefor, with a statement of the amount of tax assessed, the amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise.

Section 12 (a) of the Revenue Act of 1916 (c. 463, 39 Stat. 756, 767) provides for the deduction, in the case of a corporation, from gross income in order to determine taxable net income, of—

> All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

STATEMENT

In this action the petitioner sought to recover $450,994.06, with interest, assessed against it and

paid as additional income and excess-profits taxes for the year 1917, and was denied recovery in the Court of Claims on the ground that there had been a contract of settlement resulting from mutual concessions made by the taxpayer and the representatives of the Bureau of Internal Revenue, resulting in an adjustment in 1919 of the amount of the taxable income for 1917, and which was followed in 1920 by an amended return based on the adjustment arrived at, and the assessment and payment of the tax computed thereon.

The findings show that the petitioner is a corporation organized under the laws of New Jersey and engaged in the business of manufacturing woolen and worsted fabrics and selling them in the United States and elsewhere. (R. 10.) The corporation made an income-tax return for 1917. Thereafter, its books were audited by the Bureau of Internal Revenue with a view to readjustment of the income and excess-profits taxes of the corporation for the years 1916, 1917, and part of 1918. It appears that as a result of this audit three questions arose in respect of matters entering into the computation of the taxable income. The first was the propriety of allowing as an ordinary and necessary expense amounts paid to the company's directors purporting to be compensation for services; the second was the amount of depreciation on buildings and machinery to be charged off, and the third was the propriety of certain deductions for reserves charged

to expenses. The findings do not disclose any facts relating to the merits of the differences arising on account of depreciation and reserves, and leave us in the dark as to whether the Bureau of Internal Revenue or the taxpayer was right with respect to those items. As to the amount paid to the company's directors for compensation, the findings disclose that it has been the practice of many corporations engaged in the woolen-manufacturing business to provide compensation for the services of directors and executive officers on the basis of a percentage of profits (R. 20); that ever since its organization, in January, 1890, the petitioner's by-laws have provided a plan for annual division of the profits by which, after first providing for 6% on the stock and the creation of reserve, a percentage of the profits has been paid as a bonus or as compensation to the directors for their services. (R. 12–14.) Some changes in these by-laws were made from time to time, but the plan in effect has not varied greatly, and during the year 1917 a by-law (last amended on March 17, 1908) was in effect which read as follows (R. 14):

> PAR. 1. After the close of the first half of every business year of the company a computation of profits shall be made, and if practicable a dividend not exceeding three (3) per centum shall be paid to the stockholders. This dividend shall be payable on September 15th following.

PAR. 2. At the close of the business year the net profits shall be distributed as follows, after suitable deductions shall have been made from the value of the property of the company:

(1) A dividend of six (6) per centum is to be paid to the stockholders, in the computation of which said dividend payable on September 15th of the same business year shall be included.

(2) The balance remaining is to be applied as follows:

(a) Five (5%) per centum thereof shall be placed in a reserve fund until the amount of the reserve fund accumulated shall be equal to twenty (20%) per centum of the paid-up capital of the company for the time being.

(b) A compensation equal to thirty-two (32%) per centum of the said balance shall be allowed or paid to the board of directors for their services.

(c) The residue is to be applied to the payment of an additional dividend to the stockholders, which is to be determined by the board of directors, subject to the approval of the stockholders at the annual meeting assembled. The board of directors may, however, with such approval of the stockholders, use a portion of said residue referred to in this paragraph (c) for special deductions from accounts or for the formation of special reserve funds or additional reserves, or for extra compensation to be paid

> to employees, or for any institutions which are designed to benefit the employees, such as pension funds and other similar institutions.
>
> Said additional dividend shall be payable on April 15th following the declaration thereof, unless the directors, with the approval of the stockholders, appoint another day for its payment.

The net income of the petitioner for 1917 was $7,953,512.80 (R. 17), and under the foregoing by-law it distributed $1,565,739.39 to the 10 directors in addition to their fixed salaries of $9,000 per annum (R. 11). In filing its return for 1917 the petitioner sought to take as a deduction the full amount of the payment to the directors, but was notified by the Bureau of Internal Revenue that this deduction would not be allowed. (R. 11.)

The findings then state that (R. 18):

> After much correspondence and numerous conferences extending over a period of several months in which the plaintiff was represented by its attorney * * * the defendant represented by Sidney Alexander, chief of the special audit section, Bureau of Internal Revenue, and others of his official associates, a compromise was agreed to as to all of the differences.

These conferences appear to have commenced in 1919 and continued into 1920. (R. 11, 19.)

The items of depreciation and reserves claimed by the petitioner were allowed, but of the aggregate

sum of $1,565,739.39 paid to the directors as compensation the Commissioner of Internal Revenue disallowed $783,656.06. (R. 11.) In accordance with this adjustment, petitioner, in 1920, filed amended returns based on the figures agreed upon in the conferences, and the tax so computed was paid by the petitioner. (R. 20.) Of the additional assessment then made and paid, $450,994.06 was attributable to the disallowance by the Bureau of Internal Revenue as a deduction of part of the amount paid directors as compensation (R. 11), and it is to recover that amount that this suit was brought.

SUMMARY OF ARGUMENT

I. Acts of Congress relating to internal revenue taxes disclose a legislative intention that no adjustment of a tax controversy between the Bureau of Internal Revenue and the taxpayer is binding or conclusive unless made with the formalities prescribed by law and with the approval of officers designated by statute. These statutes are inconsistent with the contention that informal concessions and adjustments between taxpayers and representatives of the Bureau are binding on the taxpayer and the United States. While the rule that such an informal adjustment is binding would save this case for the United States, it is not in the interests of the United States or in accordance with sound public policy that such a rule be adopted. In deference to the opinion of the Court of Claims

and the importance of the question, we submit it for decision.

II. Although the question of settlement may be resolved in favor of the petitioner, the findings bearing on the question whether the amounts paid directors were compensation and necessary expenses, deductible from gross income in computing net taxable income, are not complete enough to justify this Court in directing the entry of a judgment for a stated sum, and the case should be remanded to the Court of Claims for additional findings, with leave to that court to hear additional evidence for either party.

ARGUMENT

I

NOTHING SHORT OF A SETTLEMENT MADE IN THE FORM PRESCRIBED BY LAW AND WITH THE APPROVAL OF OFFICERS DESIGNATED BY LAW SHOULD BE ACCEPTED AS MUTUALLY BINDING ON TAXPAYERS AND THE UNITED STATES

The primary question in this case is whether the Court of Claims was right in denying relief to the petitioner on the ground that a contract of settlement had been made which was binding on the parties. The court below held that but for this settlement the petitioner was entitled to recover.

The question whether adjustments brought about by mutual concessions in conference between taxpayers and representatives of the Bureau of In-

ternal Revenue, and put into effect by the filing of amended returns and the payment of the readjusted taxes, operate as contracts of settlement binding upon the parties, is one of importance. In this case to treat the arrangement as a binding settlement would operate to the advantage of the United States, but the application of the rule announced by the Court of Claims in this case would prevent the Treasury Department from reconsidering any cases in which adjustments have been so arrived at.

Section 3229, R. S., above quoted, which was in force at the time of the transactions here involved, and is still in effect, lays down a method by which the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and in some cases with the additional recommendation of the Attorney General, may make compromises and settlements of cases arising under the internal revenue laws. That statute was not complied with in this case.

Since the date of the alleged settlement here involved, and by the Revenue Act of 1921 (c. 136, 42 Stat. 227, 313), Sections 1312 and 1313, it was provided:

> SEC. 1312. That if after a determination and assessment in any case the taxpayer has without protest paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is made in

writing between the taxpayer and the Commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States.

SEC. 1313. That in the absence of fraud or mistake in mathematical calculation, the findings of facts in and the decision of the Commissioner upon (or in case the Secretary is authorized to approve the same, then after such approval) the merits of any claim presented under or authorized by the internal-revenue laws shall not be subject to review by any other administrative officer, employee, or agent of the United States.

Like methods of making conclusive agreements were prescribed by Section 1006 of the Revenue Act of 1924 (c. 234, 43 Stat. 253, 340; U. S. C. Title 26, Sec. 1249) and Section 1106(b) of the Revenue Act of 1926 (c. 27, 44 Stat. 9, 113; U. S. C. App., Title 26, Sec. 1249).

Before and since the date of the alleged settlement in this case Congress has evidently proceeded

on the theory that no adjustment of a tax controversy between representatives of the Bureau of Internal Revenue and a taxpayer is binding unless made with the formalities and with the approval of the officials prescribed by statute.

The authority of officers of the United States to compromise claims on behalf of or against the United States is strictly limited. It does not seem to be in accord with sound public policy that informal concessions and adjustments such as this record discloses be held binding on the taxpayer, and therefore upon the United States. The statutes which authorize conclusive agreements and settlements to be made in particular ways and with the approval of designated officers raise the inference that adjustments or settlements made in other ways are not binding.

No ground for the United States to claim estoppel is disclosed in the findings. They show that for petitioner's concession about compensation of directors the representatives of the Bureau of Internal Revenue acquiesced in the petitioner's claims respecting depreciation and reserves for the same tax year, but there is nothing in the findings to show that the representatives of the Bureau yielded in the matter of depreciation and reserves anything which the taxpayer was not entitled to, or that the United States has lost any rights as the result of such concessions. If the adjustment of the 1917 tax is not conclusive, the United States,

on a judicial inquiry as to the correct amount of the tax for 1917, is in as good a position as it ever was to question all deductions, to the extent necessary to defeat this claim.

In the case of *Leach* v. *Nichols,* 23 F. (2d), 275, decided December 27, 1927, by the Circuit Court of Appeals for the First Circuit, it was held that compromises of tax matters are not binding unless made in the manner prescribed by statute. The alleged settlement agreement in that case was made November 23, 1921, the very day of the approval of the Revenue Act of 1921, containing Sections 1312 and 1313, above quoted, and the court dealt with the case as if Section 3229 of the Revised Statutes, above quoted, was, as in the present case it was, the only statute in force relating to compromises of tax disputes.

It is but fair to the Court of Claims to say that at the trial of this case attorneys for the Bureau of Internal Revenue, with commendable zeal for obtaining success in this case, took the position that there was a binding agreement of settlement. On the petitioner's motion for new trial, the attorneys for the Bureau of Internal Revenue conceded that there was no binding agreement of settlement, but made a claim that the taxpayer was estopped to question the adjustment. The findings do not disclose a ground for estoppel. In other cases now pending in other courts the attorneys for the Bureau of Internal Revenue are taking the position

that no settlement or compromise is binding on a taxpayer or on the United States unless made in the manner prescribed by statute.

There are other cases pending in the Court of Claims involving the same problem.

Because of the importance of the question and in deference to the opinion of the Court of Claims, the question is submitted for the judgment of this Court.

II

THE FINDINGS OF THE COURT OF CLAIMS ARE NOT SUFFICIENTLY COMPLETE TO JUSTIFY THIS COURT IN ORDERING JUDGMENT FOR A DEFINITE SUM, AND THE CASE SHOULD BE REMANDED TO THE COURT OF CLAIMS FOR ADDITIONAL FINDINGS IF THE SETTLEMENT IS HELD NOT CONCLUSIVE

If this Court reaches the conclusion that the alleged settlement was not binding on the petitioner, the remaining question is whether, on the findings of fact made by the Court of Claims, the petitioner is entitled to a judgment for a definite sum. Stated otherwise, the question is whether the findings show that the amounts paid directors for 1917 were in fact compensation and were "ordinary or necessary expenses." The 1916 Act, above quoted, allows the deduction of—

> All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties.

The 1918 Act, which followed it (c. 18, 40 Stat. 1057, 1077), in Section 234(a) (1), provided for deduction of—

> All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered. * * *

In *United States* v. *Philadelphia Knitting Mills Co.*, 273 Fed. 657, decided in 1921, arising under the Corporation Excise Tax Act of 1909, which allowed the deduction of "ordinary and necessary expenses," it was stated that it was not open to the Bureau of Internal Revenue to inquire into the reasonableness of the compensation paid to officers and employees, but the court said (page 658):

> But, while the amount of salary fixed by a board of directors is presumptively valid, it is not conclusively so, because the Government may inquire whether the amount paid is salary or something else. * * * It has a right, therefore, to attack the action of a board of directors and show by evidence, not that a given salary is too much, but that, in the circumstances, the whole or some part of it is not salary at all but is profits diverted to a stockholding officer under the guise of salary and as such is subject to taxation.

As the decision was for the United States, it had no occasion to attempt to have it reviewed here because of anything said in the opinion.

In the case of *William S. Gray & Co.* v. *United States,* decided by the Court of Claims June 6, 1927, the court approved the statement in *United States* v. *Philadelphia Knitting Mills Co., supra,* but it has since granted a motion for new trial made by the United States, and the case is still pending in the Court of Claims.

In the present case the Court of Claims held that the settlement was conclusive. True, it has made findings on the question whether the amounts paid directors were compensation and whether they were ordinary and necessary expenses and expressed the opinion that they were; but because of its conclusion that the settlement point disposed of the case, its findings bearing on the other question are not as complete as they might have been. The findings show that the practice of paying the directors a percentage of the profits had been followed by this corporation for many years. They also show that the directors to whom these payments were made held positions as executive officers or managers of certain departments of the business. (R. 16.) There are no findings as to the extent of the service rendered by each or whether the distribution was made in proportion to the

value of the services of each, nor is there any finding as to the reasonable value of the services rendered or whether the payments were far in excess of any that might be justified as compensation for service performed. There are no findings as to the other relations which the directors bore to the corporation or as to the amount of stock held by each. We do not contend that the findings affirmatively show that the amounts paid to directors were not properly deductible. On the other hand, we can not concede that the findings are complete and adequate to support the contention that the $1,565,739.39 paid to the ten directors was for services rendered and an "ordinary and necessary expense."

The Court of Claims states that the United States did not contend that the sums paid were not in fact compensation, but only that the amount was unreasonable. The Bureau insists that the Court of Claims misunderstood its position, and that the claim that the amounts paid were unreasonable was made to sustain the claim that the sums were too large to be considered compensation, or an ordinary or necessary expense.

CONCLUSION

If the alleged settlement is held not conclusive and the judgment below is reversed, the case should be remanded to the Court of Claims for additional

findings bearing on the other issues, with leave to the Court of Claims to hear additional evidence.

Respectfully submitted.

WILLIAM D. MITCHELL,
Solicitor General.

APRIL, 1928.

○

FILED
MAY 2 1928
CHARLES ELMORE CROPLEY
CLERK

In the Supreme Court of the United States

October Term, 1927

No. 311

BOTANY WORSTED MILLS, PETITIONER

v.

THE UNITED STATES

On Writ of Certiorari to the Court of Claims

BRIEF AMICUS CURIAE

CONWAY-SCOTT COMPANY, LAW PRINTERS, DETROIT, MICH.

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In the Supreme Court of the United States

October Term, 1927

No. 659

BOTANY WORSTED MILLS, PETITIONER

v.

THE UNITED STATES

On Writ of Certiorari to the Court of Claims

BRIEF AMICUS CURIAE

The Questions Presented

The question presented is whether in a case where various disputed tax matters for the year 1917 (which involved the questions of the reasonableness of compensation paid to directors, the amount of depreciation on buildings and machinery to be charged off, and the propriety of certain deductions for reserves charged to expenses, the determination of each of which was solely a matter of opinion involving the exercise of judgment and discretion), were in good faith and after full consideration, compromised and settled finally by an oral mutual agreement between the taxpayer and the Commissioner of Internal Revenue,

which agreement was thereafter fully executed by both the taxpayer and the government by the making of an amended return and payment of the tax in accordance therewith by the taxpayer and the acceptance thereof and the closing of the case by the government, may the taxpayer subsequently, in the absence of the showing of fraud, mistake of fact, new material evidence, or error in mathematical calculation, repudiate and set aside that agreement as to a particular item which it may regard unfavorable to his interests, and as to which, in such settlement the taxpayer voluntarily accepted and agreed with the Commissioner thereon, and recover against the United States in a suit in the Court of Claims on a claim that the judgment of the Commissioner as to that particular item was erroneous, and at the same time hold, by virtue of the agreement and the running of the statute of limitations against the government, the advantages derived from the executed compromise and settlement of the other items in dispute involved in the same general settlement? Is such an executed agreement of compromise and settlement binding, and, further, is not the taxpayer under those circumstances estopped from questioning the adjustment as to such particular item?

Preliminary Statement

In the Court of Claims, the Government very properly, as we believe, contended that such an executed agreement of settlement was binding on both the taxpayer and the Government, and that the claimant was estopped from questioning the adjustment, and filed in that Court what we believe and respectfully submit is an unanswerable brief to sustain those contentions (This brief, pp. 5-39).

The Court of Claims, by a unanimous decision, in which Judges Moss, Graham, Hay, Booth and Chief Justice

Campbell participated, sustained the contention of the Government (*Botany Worsted Mills v. United States*, 63 Court of Claims, 405).

On a motion of petitioner for a new trial in the Court of Claims, the Government contended that claimant was estopped to question the adjustment, but reversed its position as to binding force of the executed agreement of settlement, and filed a brief accordingly (This brief, pp. 42-48).

The Court of Claims denied the motion for a new trial, and we respectfully submit, properly (R. 27).

The brief of the Solicitor General just filed in this Court on behalf of the Government apparently abandons both defenses, and presents an argument against the binding force of the executed agreement of compromise and settlement and states that the findings do not disclose a ground for estoppel. The brief further states that in other cases now pending, the attorneys for the Bureau of Internal Revenue are taking the position that no such agreement of settlement and compromise is binding on either the taxpayer or the United States; but in deference to the opinion of the Court of Claims the question is submitted for the judgment of this Court.

We are counsel in an important case pending in the Board of Tax Appeals which was heard and submitted a year ago and which is not yet decided. This, we presume, is one of the cases to which the Solicitor General refers, and the case mentioned by counsel for petitioner in the petition for writ of certiorari in the case at bar (Record, p. 4).

We have labored under the misapprehension that the Government intended to support the decision of the Court of Claims by a brief. We were surprised to learn just last

week through Solicitor General Mitchell of the subsequent changes of attitude of the Government in the Court of Appeals in the case at bar. He invited us to file a brief herein as friend of the court, and through the courtesy of a motion made by him on April 23, 1928, permission was granted to us by this Court to file a brief amicus curiae not later than May 4, 1928. We were unable to obtain copies of the record and briefs of counsel until April 25, 1928. The lateness of our information and the very limited time at our disposal require that we ask the indulgence of this Court and that we be content to submit as a part of this brief amicus curiae, the brief filed by the Government in the case at bar in the Court of Claims. We adopt the statement of facts and argument therein and present the same in support of the decision of the Court of Claims, which we respectfully submit should be affirmed.

In its entirety, it is as follows:

In the Court of Claims of the United States

No. D—747

BOTANY WORSTED MILLS, CLAIMANT

v.

THE UNITED STATES, DEFENDANT

DEFENDANT'S REQUEST FOR FINDINGS OF FACT AND BRIEF

Statement of the Case

This is an action to recover the sum of $450,994.06, with interest, assessed against the Botany Worsted Mills and paid as additional income and excess profits taxes for the year 1917.

The only question in the case is the claim for allowance as a deduction as an ordinary and necessary expense paid within the year 1917 of $1,585,739.39, compensation to the ten directors of the company, instead of the sum of $782,-083.32, which was allowed by the Commissioner of Internal Revenue to be deducted as such an expense.

The Botany Worsted Mills, a New Jersey corporation, had in effect the following provision in its by-laws, which was adopted by meeting of the stockholders on March 17, 1908:

> Par. 2. At the close of the business year the net profits shall be distributed as follows, after suitable deductions shall have been made from the value of the property of the company:
>
> (1) A dividend of six (6) per centum is to be paid to the stockholders, in the computation of

which said dividend payable on September 15th of the same business year shall be included.

(2) The balance remaining is to be applied as follows:

(a) Five (5%) per centum thereof shall be placed in a reserve fund until the amount of the reserve fund accumulated shall be equal to twenty (20%) per centum of the paid-up capital of the company for the time being.

(b) A compensation equal to thirty-two (32%) per centum of the said balance shall be allowed or paid to the board of directors for their services.

The net income of the claimant in 1917 was $7,953,512.80, and it paid under that by-law the total sum of $1,585,739.39 to the ten directors, distributed as follows:

Thomas Prehn	$207,367.26
Ferdinand Kuhn	51,841.83
Hans E. Stoehr	362,892.74
Max W. Stoehr	103,683.64
Georg Rohlig	311,050.88
Camill A. Mehl	207,367.26
Otto Kuhn	103,683.64
A. de Liagre	103,683.64
Eduard Stoehr	85,626.38
Georg Stoehr	28,542.12

This was in addition to a salary of $9,000.00 paid to each of the first eight of said directors, no salary being paid to the last two.

Under that by-law the claimant had paid thirty-two per cent of its net income each year to its directors, and in none of the years from 1910 to 1916, inclusive, had the Commissioner of Internal Revenue allowed any of this payment to be deducted as an expense of the business in computing its income taxes. This decision of the Government was accepted by the claimant and no claim

against that ruling was made by the company for any of those years.

In filing its income tax return for the year 1917, the claimant sought to take as a deduction the payment of that amount made to the directors in 1917. The claimant was notified by the Government that that deduction would not be allowed, and that various other claims made in the return would be disallowed, which would result in a very largely increased tax against the claimant for the year 1917. Whereupon the company, through its attorney, John Quinn, asked for a conference on the subject. Many conferences were held and finally the various questions at issue were settled and agreed upon between the parties as a give-and-take proposition on the various items, the settlement was agreed to by the directors of the complainant, and the tax paid and the matter closed in the company's affairs.

The stockholders of the claimant corporation on July 30, 1918, amended the by-law quoted above and provided that the directors should receive "such sum *not exceeding* thirty-two per cent" of the balance of the net profits as the board of directors should determine. Thereupon, the board of directors allowed for compensation to the directors for the year 1918 approximately sixteen per cent of the balance of the net profits, which amount was satisfactory to the directors interested, and which amount was approved by the Commissioner of Internal Revenue and allowed as a deduction as a necessary expense for the year 1918. It was then agreed that the compensation to directors for the year 1917 should be of the same percentage or proportion of the net profits as was agreed upon by the directors of the corporation as a reasonable compensation for 1918, and which was approved by the Commissioner of Internal Revenue as a deduction as a necessary expense, and this percentage of sixteen per cent as the deduction

was allowed and agreed to for the year 1917 as a part of the settlement of all the items in dispute, and this tax was duly assessed and was paid June 28, 1920.

Thereafter, on February 1, 1922, the claimant filed a claim for refund for the amount at issue in this suit, which was denied by the Government on the ground that there had been a complete settlement of this item and of the other items which had been approved by and accepted by both parties.

The only question in the case is the right of the claimant at this time to increase its deduction as an ordinary and business expense, the percentage compensation or bonus paid to directors for the year 1917 from $782,083.32, the amount allowed to be deducted by the Commissioner of Internal Revenue, to the sum of $1,585,739.39, which would result in a decrease of the tax due and paid in the sum of $450,994.06.

DEFENDANT'S REQUEST FOR FINDINGS OF FACT

The defendant, deeming the facts stipulated to be material to a due presentation of this case in the findings of fact, requests the Court to find the same as stipulated, and also to find the facts as found by the Commissioner of Court of Claims in his finding No. XX from the testimony taken.

The Statutes

The applicable section of the Revenue Act of 1916 in force in 1917 provides as follows:

> SEC. 12. (a) In the case of a corporation joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the

gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

ARGUMENT

1. The various tax matters of the company for the year 1917 were compromised and settled by mutual agreement and neither party may seek to cancel a part of that settlement

2. The amount paid the directors for 1917 was not an ordinary or necessary expense and was not a reasonable compensation beyond the amount allowed by the Commissioner of Internal Revenue

1. The various tax matters of the company for the year 1917 were compromised and settled by mutual agreement and neither party may seek to cancel a part of that settlement

The record in this case shows very clearly and plainly that the various matters in dispute regarding the taxes of the claimant for the year 1917 were compromised and settled by mutual agreement and the matter was closed by both parties. This is shown by the minutes of the claimant corporation and by the letters of its officers and attorney.

There were a number of matters disputed by the company, including the question involved in this suit, also depreciation and invested capital and a number of minor items.

Attention is called to the following parts of letters and of the minutes of the meetings of the directors of the corporation:

Exhibit 70 is a letter from the claimant to the Commissioner of Internal Revenue, dated January 17, 1918. (This letter was written by the old company, with the old board of directors, and before the Alien Property Custodian took over control of the stock of the company.)

> * * * Furthermore, we think that it will be to the interest of the Government as well as ourselves to have a definite understanding as to this subject of compensation paid to our directors, so that it may be settled once and for all—not only in reference to the year 1909, but also for the year 1917, and subsequent years.
>
> * * * * *
>
> For all of the above reasons we request a decision permitting us to charge this compensation as a deduction from gross income. (We beg to state in this connection that we do not make any claim for the intervening years, that is commencing with 1910 and ending with 1916, both inclusive, which we shall consider settled.)

Exhibit 32. Board meeting, July 11, 1919.

Exhibit 80. This is a letter written by the attorney for the claimant to the Commissioner of Internal Revenue, after the conference proposing the basis for the compromise and settlement of the matters of deduction for bonus and depreciation.

> (6) In accordance with Mr. Alexander's and Mr. James' suggestion that the principles adopted by the Board regarding extra compensation to executives and the amounts paid for the year 1918 would be adopted and applied to extra compensation for the year 1917, the Assistant Treasurer of the Company, Mr. W. J. Hellmer, has, in accordance with my direction, prepared and I inclose herewith a statement showing the reasonable compensation of the executives of the Botany Worsted Mills for

the year ending November 30, 1917, based upon the compensation to executives under contracts and under the recommendation of the special committee of the Board for additional compensation for the year ending November 30, 1918. This is the paper marked at the top in red ink "Exhibit 6."

* * * * *

Of the ten executives named on said list, Thomas Prehn, Ferdinand Kuhn, Otto Kuhn, and Camill Mehl served for the entire year, both in 1917 and 1918. Their reasonable compensation, therefore, for 1917 is based on their contract compensation for 1918, plus the additional compensation recommended by the Board of Directors for the year 1918. This, I think, explains itself from the statement.

* * * * *

* * * If the extension to the year 1917 of the principle adopted and approved for the year 1918 regarding extra compensation to executives, as shown in said Exhibit 6, be approved by your Department, as I respectfully submit justice and equity requires it should be approved, it will result in the disallowance by your Department of the difference between said $1,565,739.39 and the said sum of $782,083.32 arrived at in said Exhibit 6, or the sum of $783,656.08.

* * * * *

For the reasons stated by me to you, I should appreciate it if your Department can let me have its decisions and rulings in these matters for said two years as promptly as possible, in order that I may take the matters up with the Board of Directors of the company. For the reasons which I stated at the hearing it is desirable to have these open questions settled and closed as speedily as possible for the years 1917 and 1918.

P. S.—The report of the subcommittee on additional compensation to executives, composed as stated of Messrs. Wallace, Duvall, Maloney, and Howell, was unanimously approved by the Board. Of the eleven members of the Board, nine were nominated by the Alien Property Custodian, and two only—Ferdinand Kuhn, the President, and Thomas Prehn—remained over from the old Board. The other members of the Board who apprved the report of the subcommittee were: Mr. Horace C. Jones, a well-known wool expert and wool manufacturer of Conshohocken, Pa.; Mr. Wm. H. Folwell, of Folwell Brothers, large dealers in wool, of Phila., Pa.; Mr. Thomas F. Martin, the Sec. of State of N. J., a man of wide experience in business and of high standing in business and corporate affairs; Mr. Wm. J. Hellmer, the Assistant Treas. of the company and an expert accountant; and Col. Douglas I. McKay, an acknowledged expert in corporate management.

The subcommittee had many sessions on the subject of said compensation, and their report and the action of the Board in unanimously approving their report for the year 1918 was the result of their independent and disinterested judgment as to the reasonable requirements and the necessities of the company and of its business, and in the best interests of its stockholders and in entire good faith, for none of the nine directors nominated by the Alien Property Custodian is a stockholder of the company and not one participated to the extent of one dollar in any additional compensation or bonus.

Exhibit 34. Board meeting, August 22, 1919.

Exhibit 83. This is the official notice, dated September 11, 1919, from the Commissioner of Internal Revenue to the claimant, giving the amounts due for the 1917 taxes, and it states:

The adjustments referred to above have been made on the findings of the Revenue Agent and

also on the agreement reached in several conferences with Mr. John Quinn, your representative, of which you are, no doubt, familiar.

Exhibit 54 is a letter from the Assistant Treasurer of the company to its counsel, John Quinn, where it is stated:

> The amount of $783,656.06, disallowed as a deduction in 1917 for additional compensation to Directors, being the result of your previous conference with the Department, has already been accepted by the Company.

Exhibit 39. Board meeting, November 14, 1919.

Exhibit 41. Board meeting, December 12, 1919.

Exhibit 49. Board meeting, April 23, 1920, where it is stated:

> * * * Counsel succeeded some time ago in effecting a compromise on the question of bonuses to directors and the amount transferred from depreciation on buildings and machinery to the surplus account, as to which counsel made a report to the board and which was satisfactory to the board.
>
> The company then received an assessment of $1,144,821.02, covering the years 1916, 1917, and part of 1918. This assessment was the subject of careful consideration by the company and conferences with counsel and conferences with the Department by counsel, and the subject of supplemental memoranda and hearings.
>
> At the last hearing there was a great deal of discussion in regard to the reluctance of the Department to allow for those years the large items of bonuses to employees and deductions for reserves, but they finally agreed to allow the bonuses to employees, the deductions for reserves, and all of counsel's other points.

Counsel arranged an adjustment of the bonuses for the year 1917 on the same relative basis as the bonuses for the year 1918, approved by the reorganized board.

Assuming that the bonus to directors in 1917 will remain as originally agreed to, that is, on the relative basis of the 1918 bonus, the additional tax to the Government for the years 1916, 1917, and 1918 will amount to $718,770.11.

This shows a saving to the company between the original amount claimed and what will be the final assessment, of $663,507.16.

The Government accepted the contentions presented by counsel for the company on all of the essential questions that counsel for the company and the officers of the company felt were right and proper under the law and facts.

* * * Counsel's opinion was that corporations may legally and properly make contracts with their executives for compensation on such basis as the directors of the company in good faith believe to be in the best interests of the company, and that the fact that such compensation may be in excess of the amounts ultimately allowed by the Department for income tax purposes, would not be the basis of a claim against the executives. * * *

Exhibit 92 is a letter dated May 12, 1920, from the attorney for the claimant to the Commissioner of Internal Revenue forwarding the amended returns compiled in accordance with the compromise and settlement agreements. It states:

Pursuant to the understanding arrived at at the conference held in Washington on April 9, 1920, between Mr. Akers, Mr. Kane, Mr. Hellmer, and myself, I enclose you herewith the following papers in the above matter:

* * * * *

These statements explain themselves and show in condensed form the differences between the reports as originally made, and the amended reports, herewith submitted, and the amended reports are in all respects based upon the conclusions arrived at at the preceding and last conferences.

* * * * *

The said amended returns and the above described enclosures give you fully and truthfully all of the details and computations which were discussed at the last conference, and the preceding conferences, and will, I am sure, enable the Department to make a speedy disposition of this matter. As Mr. Hellmer and I said at the last conference, by sending in the amended returns for said years, based upon the figures agreed upon, it will make the work of the department in checking up the returns, in the light of the enclosed papers, and the balance sheet which you already have simple and expeditious and exclude possibilities of error.

* * * * *

Upon their approval, I take it that the next step would be the rendition of new assessments for said three years, which will be promptly paid to the Collector of Internal Revenue for Newark, New Jersey, thus closing the entire matter.

After the figures were agreed upon and all the matters compromised and settled, the company executed an amended income-tax return for the year 1917, giving the figures as compromised and settled, and this amended return was reported to the board of directors at their meeting of May 14, 1920, as shown by Exhibit 50, in which the counsel for the company reported that he had examined and approved the amended income tax-return, that it had been forwarded with a full explanatory letter, and then said:

The next step will be the rendition of new assessments for the said three years and the payment of the additional taxes to the Collector of Internal Revenue at Newark, New Jersey, which will close the entire matter.

Exhibit 51. Board meeting, June 11, 1920.

> * * * it does not differ from the balance sheet previously submitted, except in respect of the increase of the amount of taxes due the Government as per the adjustment recently reached with the Department of Internal Revenue. * * *

Exhibit 57. Board meeting, June 16, 1920.

Exhibit 95 is a letter dated June 17, 1920, from the Assistant Treasurer of the company to the attorney of the company, in which it is stated:

> We enclose herewith copy of letter received yesterday afternoon from Mr. G. V. Newton, Deputy Commissioner of Internal Revenue, dated June 15, 1920, advising that upon reaudit of our tax returns for the fiscal years ended November 30, 1916, 1917, and 1928, additional taxes amounting to $710,969 were disclosed.
>
> By comparing the enclosed letter with your letter of May 12, 1920, to the Hon. Wm. M. Williams, Commissioner of Internal Revenue, Washington, D. C., you will note that the Department has accepted our returns for 1916 and 1918 as rendered, said returns showing an additional tax due for 1916 of $7,390.63 and a refund due us for 1918 of $116,281.61. You will also note that for the year 1917, they show additional tax due of $819,859.98, whereas your letter shows additional tax due of $808,021.37, making a difference of $11,838.61.

Exhibit 97, being a letter dated June 23, 1920, from the attorney of the company to the Commissioner of Internal

Revenue referring to taxes for the year 1917, in which he says:

> Thanking you for your courtesies in this matter, and with appreciation of the fact that it is finally closed up, which enables the Botany to finally close its books for those years, I am. * * *

Exhibit 52. Board meeting, June 25, 1920.

> For the year 1917 the figures given by the Department showed additional taxes due of $819,-859.98, whereas the figures agreed upon between Mr. Quinn and the Department for that year showed additional taxes due of $808,021.37, making a difference of $11,838.61 of additional taxes.

Exhibit 99 is a letter dated June 29, 1920, from the Assistant Treasurer of the company to the attorney for the company, in which it is stated:

> However, the payment has now been made and I hope the matter is closed as I agree with you that to contest their ruling regarding the amount of $11,838.61 might open the door for further assessments covering said years.

Exhibit 101 is a letter from the attorney of the company to the office of the Commissioner of Internal Revenue, dated July 17, 1920, after the tax had been paid as compromised and agreed upon, in which counsel says:

> I am obliged by the receipt of your letter of July 14th giving the basis of the computation of the tax for the fiscal year 1917, in answer to the claim for a difference of $11,381.61 as set forth in my letter of June 23, 1920, to you. The tax was paid in full on June 28, 1920, in accordance with your ruling. I have sent a copy of your letter of July 14, 1920, to the Botany Worsted Mills for its records, and the matter is now closed.

In the testimony given by the witnesses for the Government, all of whom had participated in one or more of the conferences with representatives of claimant on these matters, it is stated that the various matters were settled and compromised as a give-and-take proposition and that more was allowed on one item and less on another item in order to have the whole matter settled and compromised.

The claimant introduced no testimony whatever and called none of its representatives who took part in these conferences.

The record, therefore, plainly and positively shows that all of the matters in controversy between plaintiff and the Government as to taxes for 1917 were agreed to, compromised, and settled as a whole and no one item by itself, but the entire compromise was dependent upon the settlement of each and every item.

The fact that the agreement was "a gentlemen's agreement," that is, it was not reduced to writing, makes no difference. It was accepted and executed by both parties, and became an executed contract. It could then be rescinded only for fraud or mistake, neither of which is claimed in this case, and even then only by restoring the status which existed before.

Ostrum v. *City of San Antonio,* 71 S. W. 304.

McLean v. *Clapp,* 141 U. S. 429.

Grymes v. *Sanders,* 93 U. S. 55.

That a compromise settlement, which has been agreed to and executed, is closed and can not be opened up by one of the parties, has lately been decided by this Court in the case of *The Lone Star Brewing Association* v. *United States,* decided November 2, 1925. This Court said:

> The cause of action presented by the plaintiff in its petition arises from transactions having to do with the taxes and penalties of 1916 and 1917, and we can not go back of the agreement of the parties and open up a transaction which has been closed by the act of the parties.
>
> (Case not reported yet.) T. D. 3778.

A petition for certiorari in that case was denied by the Supreme Court, 271 U. S. 680.

A similar case has very lately been decided by the Circuit Court of Appeals for the Fifth Circuit, in which case the court said:

> A party against whom taxes have been assessed is at liberty to make or accept or to refrain from making or accepting an offer of compromise. The making of an offer of compromise is a voluntary act, and the contract resulting from its acceptance is binding on a party unless his consent to the contract was illegally obtained. (*Ostrum* v. *City of San Antonio*, 71 S. W. 304; *Palomares Land Co.* v. *Los Angeles County*, 146 Calif. 530; *Lee* v. *Inhabitants of Templeton*, 15 Gray 476.) * * * The payments now in question were made, not in compliance with any official demand or statutory requirement, but in pursuance of an agreement to which the plaintiff was a party, and without protest or notice that in making or complying with that agreement the plaintiff acted otherwise than voluntarily. The making of that agreement was authorized by the statute providing for the compromise of any civil or criminal case arising under the internal revenue laws. R. S. 3229, Comp. Stat. #5952.) A compromise by which the authorized representatives of the Government agreed to take, and the plaintiff agreed to pay, a less sum than had been assessed against the latter, had the effect of extinguishing the controversy between the parties to the contract. (*Little* v. *Bowers*, 134 U. S. 547, 556.)

The matters which were in controversy between the parties to the compromise before it was made are not subject to be reopened if the compromise was binding on the parties, and the question whether it was binding is determined by rules applicable to contracts generally. A payment made pursuant to a contract can not be recovered back without annulling or canceling the contract, and that can not be done unless the payer's consent to the contract was illegally obtained, or without his taking prompt action to annul or avoid the contract and restoring the status which existed before the payment was made. The party seeking to get back what he has paid can not retain the benefits of the contract and escape its burdens. (*McLean* v. *Clapp*, 141 U. S. 429; *Grymes* v. *Sanders*, 93 U. S. 55; *Multnomah* v. *Title Guaranty & Trust Company*, 46 Oregon, 523.) The indictment mentioned having been dismissed pursuant to the compromise agreement, it is obvious that it was impossible to restore the status which existed before that agreement was made. In the situation which existed between the date of the making of the demand that plaintiff pay the amount of the assessment finally made and the date of the compliance with the compromise agreement it was open to the plaintiff either to pay under protest the amount assessed and sue for the whole or any part thereof claimed to have been erroneously or illegally assessed or collected (Comp. Stat. 5949), or to avail itself of an opportunity to settle by compromise the matters in controversy. It chose the last-mentioned alternative. By this suit it claims that it was as free to attack the assessment as it would have been if it had chosen the other alternative. No finding made indicates that in making the compromise the plaintiff acted without full knowledge of all the circumstances, or that it was influenced by any constraint except such as resulted from the facts that when the agreement was made the above-mentioned indictments against one of its officers was pending

and the collector had means of promptly enforcing collection of the assessment made. * * *

The court's ruling was to the effect that the plaintiff was entitled to treat the compromise agreement as a nullity and to maintain an action to recover back the amount wrongfully assessed, because at the time that agreement was made plaintiff was subject to be coerced to pay a larger sum than the one it agreed to pay and its representative was subject to be tried under the indictments against him, though the plaintiff did not promptly take action to avoid or annul the compromise agreement and could not restore the status which existed before that agreement was made and complied with. We are of opinion that that ruling was erroneous, and that on the state of facts found plaintiff was not entitled to recover back the whole or any part of the sum it paid in pursuance of the compromise agreement.

Walker v. *Alamo Foods Co.* (Not yet reported.) Decided January 4, 1927.

The Circuit Court of Appeals for the Second Circuit also has held that where a compromise has been accepted and executed, the Government may not then ignore the settlement and bring the other party into court on a matter which was covered by the compromise agreement. (*Rau* v. *United States,* 260 Fed. 131.)

In these cases the compromise was offered and accepted under Section 3229 R. S. But the rule is general and is just the same under a compromise settlement made under the general principle of contract. Or as the Court said in the *Alamo Foods case, supra:*

> The matters which were in controversy between the parties to the compromise before it was made are not subject to be reopened if the compromise was binding on the parties, and the question whether it was binding is determined by rules applicable to contracts generally.

In those cases the record shows that the compromise was expressly offered and accepted under Section 3229 R. S. In the case at bar the record does not show if the compromise was made under that section or that the provisions of that section were not complied with. But in any case that section is not exclusive, particularly in a case of this character.

The various matters being considered in this case, viz, a fair and reasonable compensation for directors, and a proper amount to be allowed for depreciation, are not certain and fixed amounts which can be absolutely determined. But they are matters which depend upon the ideas and judgment of the individual who passes on them; and in questions involving such large amounts as in this case, it is certain that there would be wide differences in the resulting judgment and conclusion of the different individuals who sought to determine them.

These are, therefore, matters which, when conferences were held and the results were satisfactory to both parties, almost necessarily must have been determined and settled by compromise and agreement.

The right and power exist to determine such matters by agreeing upon the various amounts or matters in controversy, and the right to settle and compromise a claim or demand under the rules applicable to contracts is well settled.

It is a principle settled by the Supreme Court of the United States that disputed claims by or against the United States may be compromised and settled without suit or trial.

> Unconditional acceptance of the medium of payment different from that promised by the United States, or absolute acceptance of a smaller sum from the Secretary of the Treasury than the one

claimed from the United States, even in a case where the amount relinquished is large, does not leave the United States open to further claim on the ground of duress, if the acceptance of the different medium or the smaller sum is voluntary, and without intimidation, and with a full knowledge of all the circumstances; nor is the case changed if it appears that the claimant was induced to accept the different medium or the smaller sum in full as a means to secure an earlier payment of the claim than he could otherwise hope to procure. (*Mason* v. *United States*, 17 Wall. 74.)

Parties having claims against the United States, which are disputed by the officers authorized to adjust the same, may compromise the claim, and may accept payment in a different medium from that promised, or may accept a smaller sum than that claimed; and where it appears that the claimant voluntarily entered into a compromise, and accepted payment in full in a different medium from that promised, or accepted a smaller sum than that claimed, and executed a discharge in full for the whole claim, or voluntarily surrendered to the proper officer the evidences of the claim for cancellation, he can not subsequently sue the United States, and recover in the Court of Claims for any part of the claim voluntarily relinquished in the compromise. (*Sweeney* v. *United States*, 17 Wall. 77; *United States* v. *Child*, 12 id. 244; *United States* v. *Justice*, 14 id. 549.)

Decisions of the kind by this court are quite numerous, and they show beyond all doubt that parties may adjust their own controversies in their own way, and that when they do so voluntarily, and with a full knowledge of their rights and all the circumstances, no appeal lies to the courts to review their mutual decision. Courts can not make contracts for parties; and if parties understandingly contract to adjust a controversy between them in a particular way, and actually execute the contract,

> they are both bound to regard the controversy as at an end. (*Savage, Exec.*, v. *United States*, 92 U. S. 382, 388-389.)

This general principle of law with regard to claims by or against the United States was not abrogated or repealed by Section 3229.

And while the record does not show if this settlement and compromise was made under Section 3229, it is valid whether made under that section or without it.

Claimant's argument in his brief that the "gentlemen's agreement" could not have been enforced by claimant against the Government is beside the question. We are considering an *executed* agreement, not the power to compel the carrying out of an oral or gentlemen's agreement. The decisions of the Supreme Court quoted above, are decisive of the validity of the executed agreement or compromise as in this case.

That the claimant made the settlement or compromise, that it was fair and right and just to claimant, that claimant was anxious to make the settlement, and that claimant received all which it believed was right and proper under the law and the facts and that the matter was closed by claimant are shown by the statements of claimant's officers and the minutes of the meetings of its Board of Directors.

Thus in Exhibit 80, claimant's attorney writes:

> If the extension to the year 1917, of the principle adopted and approved for the year 1918, regarding extra compensation to executives, * * * be approved by your Department, as I respectfully submit *justice and equity requires it should be approved,* * * * it is desirable to have these open questions *settled and closed* as speedily as possible for the years 1917 and 1918. * * *

> Their report and the action of the Board in unanimously approving their report for the year 1918, was the result of *their independent and disinterested judgment* as to the reasonable requirements and the necessities of the Company and its business, and *in the best interests of its stockholders* and *in entire good faith.*

In Exhibit 54, the Assistant Treasurer of claimant writes:

> The amount of $783,656.06 disallowed as a deduction in 1917 for additional compensation to Directors, being the result of your previous conference with the Department, *has already been accepted by the Company.*

In Exhibit 49 the minutes of the Board show that its counsel reported:

> *Counsel succeeded* some time ago in *effecting a compromise* on the question of bonuses to directors and the amount transferred from depreciation on buildings and machinery to the surplus account, as to which counsel made a report to the board and *which was satisfactory to the board.* * * * *The Government accepted the contentions presented by counsel for the company on all of the essential questions that counsel for the company and the officers of the company felt were right and proper under the law and facts.*

In Exhibit 92, a letter from the attorney for claimant, he writes:

> The said amended returns and the above described inclosures give you fully and truthfully all of the details and computations which were discussed at the last conference, and the preceding conferences, and will, I am sure, enable the Department to make a speedy disposition of this matter. * * * Upon their approval, I take it that the

> next step would be the rendition of new assessments for said three years, *which will be promptly paid* to the Collector for Newark, New Jersey, *thus closing the entire matter.*

In Exhibit 50, the Board minutes state that the attorney for claimant reported that he had examined and approved the amended income tax returns (which were executed by the President and Assistant Treasurer of the claimant. Exhibits 107-110), and he said:

> The next step will be the rendition of new assessments for the said three years and the payment of the additional taxes to the Collector of Internal Revenue at Newark, New Jersey, *which will close the entire matter.*

In Exhibit 97, the attorney for claimant writes:

> with appreciation of the fact that *it is finally closed up,* which *enables the Botany to finally close its books* for those years.

In Exhibit 52 the Board minutes speak of "the figures agreed upon between Mr. Quinn and the Department."

In Exhibit 99 the Assistant Treasurer of the claimant, who participated in the conferences writes:

> the payment has now been made and *I hope the matter is closed* as I agree with you that *to contest their ruling* regarding the amount of $11,838.61 *might open the door for further assessments* covering said years.

This shows that claimant knew it has settled some of the matters in dispute for less than it might be liable to pay.

In Exhibit 100 the attorney for claimant writes the Commissioner of Internal Revenue:

> *The tax was paid in full* on June 28, 1920, *in accordance with your ruling.* I have sent a copy of

> your letter of July 14, 1920, to the Botany Worsted Mills *for its records, and the matter is now closed.*

Claimant states in its brief (p. 35):

> That the plaintiff's directors did not consider that a compromise settlement had been made or authorized is shown by the fact that the Company, on February 1, 1922, while still controlled by the Alien Property Custodian, filed with the Commissioner a claim for refund.

Of course even if this were the fact, it would simply show that the claimant, while retaining the benefits it had received from the compromise settlement, was seeking to recover from the Government what the Government had received for its consideration.

But the record does not show what is stated above, but quite the contrary.

The only directors in 1921 and 1922, who were directors in 1918, are Ferdinand Kuhn and Horace C. Jones (stipulation, paragraphs XXVI, XXXV). Also, the record does not show that the directors had anything to do with the claim for refund (stipulation, paragraph V).

And the record does show that there was a different Alien Property Custodian in 1922 and a new attorney for the claimant, who did not have copies of the material correspondence regarding the compromise settlement and did not know what had been done, and was not conversant with the facts in the case.

After the claim for refund was rejected, the new attorney for the claimant wrote the Commissioner of Internal Revenue on October 3, 1922, as follows:

> The letter of September 26th refers to letters of June 23 and July 17, 1920, and Mr. John Quinn, then the attorney of the Alien Property Custodian,

> upon which letters apparently considerable weight is placed in reaching your decision. As I have never had the privilege of seeing these letters, I respectfully ask that copies of the same be forwarded to me so that I may be fully conversant with all of the facts in the case. You will appreciate that I am asking this because the present Alien Property Custodian had no previous connection with the case and was not represented by Mr. Quinn, and therefore we have no copies of these letters available. (Exhibit 104.)

It is submitted that this letter shows conclusively that the claim for refund was prepared and filed by parties who did not know what the facts were nor what had been done in the matter.

It is submitted that there was an agreement of settlement or compromise which was executed and which was so understood by all the parties, including the Board of Directors of the claimant, as is shown by the testimony of all witnesses in the case who had knowledge of what had been done, as well as the letters of the officers of the claimant to its attorney, and the letters of the attorney for the claimant, and the minutes of the Board of Directors of the claimant. That the questions sought to be raised in this case were considered and discussed at the time and that the attorney for claimant notified the Board of Directors of claimant that "The Government accepted the contentions presented by counsel for the company on all of the essential questions that counsel for the company and the officers of the company felt were right and proper under the law and the facts." That it is not alleged or claimed that there was any mistake or fraud in the matter, and no offer or attempt is made to put the parties in status quo.

It is therefore submitted that the executed agreement or compromise is a bar to this action.

2. The amount paid the directors for 1917 was not an ordinary or necessary expense and was not a reasonable compensation beyond the amount allowed by the Commissioner of Internal Revenue.

The statute allows a deduction for "All the ordinary and necessary expenses paid within the year." (Act 1916, Section 12 (a). First.)

The Regulation duly issued on this point is as follows:

> Art. 138. Bonuses or additional compensation.—Special payments, sometimes denominated as gifts or bonuses to employees of corporations, will constitute allowable deductions from gross income in ascertaining net income for the purpose of the income tax, when such payments were made in good faith and as additional compensation for the services actually rendered by the employees. If such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered, they will be regarded as a part of the wage or hire of the employee, and therefore an ordinary and necessary expense of operation and maintenance, and as such deductible from gross income.
>
> Special payments made to officers or employees who are stockholders, in the guise of additional salaries or compensation, the amount of which is based upon or bears a close relationship to the stockholdings of such officers or employees or the capital invested by them in the business of the company, will be regarded as a special distribution of profits, or compensation for the capital invested and not payment for services rendered. Payments under such latter conditions being in the nature of dividends, will not be deductible from gross income.
>
> Salaries of officers or employees who are stockholders will be subject to careful analysis, and if they are found to be out of proportion to the volume of business transacted, or excessive when compared with the salaries of like officers or employees

> of other corporations doing a similar kind or volume of business, the amount so paid in excess of reasonable compensation for the services will not be deductible from gross income, but will be treated as a distribution of profits. (Regulations 33.)

The regulation was a valid interpretation of the law; and by the reenactment of the law of Congress, Congress is presumed to have recognized and approved the regulation and practice of the Department.

Provost vs. United States, 269 U. S. 443.

United States vs. Anderson, 269 U. S. 422.

Baltzell vs. Mitchell, 3 Fed. (2d) 428, 430.

But it is so much stronger in this case because in the Law of 1918, Congress, in order to avoid any question or doubt, added words which practically made the regulation an express part of the law, and provided:

> All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered. (Act 1918, Sec. 234 (a) (1).)

The by-law of the claimant under which the payments were made is as follows (italics ours):

> Article 21. Par. 1. After the close of the first half of every business year of the company *a computation of profits shall be made.* * * *
>
> Par. 2. At the close of the business year *the net profits shall be distributed as follows*, after suitable deductions shall have been made from the value of the property of the company:
>
> (1) A dividend of six (6%) per centum is to be paid to the stockholders * * *.

(2) The balance remaining is to be applied as follows:

(a) Five (5%) per centum thereof shall be placed in a reserve fund * * *

(b) A *compensation* equal to thirty-two (32%) per centum of the said balance shall be allowed or paid *to the Board of Directors for their services.*

(c) The residue is to be applied to the payment of an additional dividend to the stockholders, * * *. (Exhibit 8.)

It is thus clearly stated that the amount paid is part of the distribution of the *net profits*, and is not a part of the salaries paid as expenses.

After all expenses have been paid and suitable deductions have been made from the value of the property, the net profits are distributed by paying a 6% dividend, then this payment as compensation to the board of directors for their services, and then the balance is paid as an additional dividend.

So that this amount is not expenses at all, but a part of the distribution of the net profits.

The Act of 1916 as other acts provides:

That there shall be levied, assessed, collected, and paid annually upon the total net income received * * *. (Act 1916, Sec. 10.)

So that there is at least a strong doubt if any payments made from the "*net profits*" of the company, after salaries and all other expenses are deducted, may then be deducted as salaries or expenses.

These payments are not salaries, for *directors* do not receive salaries. Each director had, however, received a salary of $9,000.00 for the year 1917 (Stipulation III)

which had been raised from $6,000.00, which was the amount paid from 1908 to 1916. Whether this salary was for his services as a director or for other services, the record does not show.

Claimant does not contend in its brief or elsewhere that the amount paid in 1917 to any director was *reasonable* and of course it cannot successfully so contend. In fact, claimant in its brief does not mention the amount paid to any director.

The facts show that the payments were extraordinary in amount, and must be so conceded by anyone.

They show that one director in addition to his salary was paid in 1917 *over $362,000.00*. Almost five times the salary of the President of the United States! The other directors in addition to their salaries were paid over $311,000.00, $51,000.00, $207,000.00, and $103,000.00 each. (The two who served only part of the year are considered later.) Stupendous sums, and not a word offered to show what services were rendered, if any, or what the services were worth. The record shows what position or office was held by each director but nothing regarding what services he rendered. But these sums were paid as compensation for the services of the *director* only.

A director's services, as director, are in serving on the board of directors, attending the meetings, and taking part in the discussion of the matters coming before the board, and voting thereon. But the record does not show what of such or other services were rendered by any of the directors during this year. But the record does show that services rendered had no relation to this payment. This is shown by the following:

(a) Eduard Stoehr and Georg Stoehr were living in Germany during 1916 and 1917, so that they could not attend any meetings or render any services as director.

(b) These two were German citizens, living in Germany, and were unable to leave that country (*if* they desired to). War with Germany was declared by our country on April 6, 1917. Yet these two were allowed compensation as directors of claimant until June 30, 1917.

(c) Neither of these received any salary from claimant in 1915 or 1916.

(d) Eduard Stoehr held no position with the company in 1917 other than as a director.

(e) At a meeting of the board of directors held on August 29, 1918, counsel advised that 5/12ths of the compensation for the year 1917 of these two directors, being for the period after their resignation, should be distributed among the remaining directors. So over $81,000.00 additional was given to the eight directors who had already received such huge sums from the *net profits* as "compensation," which, of course, had no relation to any services whatever, and was not compensation for anything. (Exhibit 20.)

These stupendous sums, being part of the net profits distributed to these parties who were directors, were *extraordinary*, and can not be considered or called "*ordinary* expenses" under any circumstances or conditions. Nor were they necessary expenses.

The by-law of the company could be changed at any time, and in fact was changed at the meeting held on July 30, 1918. This amendment, among other things, changed "32%" to "not exceeding 32%," and in accordance therewith the amount was cut to 16% for the year. Though eight months of the fiscal year had passed, it was not claimed that the company did not have the right to amend or repeal the by-law.

Counsel for claimant also advised its board of directors that the question of the legality of a contract for compensation between the corporation and its executives was distinct from the question of the amount which would be allowed by the Department for income-tax purposes. (Exhibit 49.)

Attention has heretofore herein been called to the fact that the board of directors approved the report of the committee for 1918, which was for the percentage, 16%, which claimant asked the Commissioner to allow for 1917 (and stated *justice and equity* required it should be approved by the Commissioner) and that report "was the result of their independent and disinterested judgment as to the reasonable requirements and the necessities of the company and its business, and in the best interests of its stockholders and in entire good raith." And counsel told the board of directors "The Government accepted the contentions presented by counsel for the company on all of the essential questions that counsel for the company and the *officers of the company felt were right and proper under the law and facts.*"

The fact that no deduction for these extraordinary payments was taken or allowed for the years 1910 to 1916, inclusive, and the company made no claim for these years and considered them as settled (Exhibit 70) shows that the claimant felt and knew that these extraordinary payments to the directors were not ordinary and necessary expenses, and the claimant did not consider them as such.

The record shows that each director was a stockholder, but in a small amount, so that the extraordinary compensation to him as a director was not in proportion to his stockholding. It does show, however, a close relationship between some of the stockholders and the holders of the main stock of the company. And only some such personal

relationship could explain or countenance the payment of $86,000.00 for 1916 and of $113,000.00 (for seven months) of 1917 to two directors who were in Germany all of this time and could not act as directors, or render any service to the company for these large sums.

The law reports show, so far as has been found, no case in which compensation to *directors* has been considered. The question of salaries paid to executives is a different question, (but one in which the position of the taxpayer is much stronger. However, even these cases all support the Government's position in this case.

In *Jacobs & Davies, Inc., vs. Anderson,* the Circuit Court of Appeals for the Second Circuit said:

> They called those sums "compensation," but the court held that they must be treated as income of the corporation. To enable the company to deduct these amounts it must appear that they were paid as salaries for services actually rendered.* * * They were not compensation, because the salaries of both the parties are fully provided for in the agreement of April, 1909. It seems plain that they were profits of the business and as such were subject to the tax. Their payment did not depend on the services rendered. Whether the stock was distributed among a large number of holders or only two, it can hardly be maintained that the amount paid out in dividends should be deducted in order to ascertain the amount of the net income of the corporation. That must be determined by deducting from the gross amount of the income all ordinary and necessary expenses actually paid within the year. The distribution of surplus profits was not an ordinary and necessary expense paid in the maintenance and operation of the business. (*Jacobs & Davies, Inc. vs. Anderson,* 228 Fed. 505, 506.)

In *United States vs. Philadelphia Knitting Mills Company* the Circuit Court of Appeals for the Third Circuit held that the Government could not inquire whether salaries were reasonable, but the court's attention was not called to any regulation on the subject, and this was not considered by the court. And what the court said on this question is merely dictum, for it decided that the payments made were not for services actually rendered, but were a diversion of profits. The court said:

> To be a necessary expense it must have been paid for services actually rendered. (*Jacobs & Davies, Inc., vs. Anderson*, 228 Fed. 505, 506, 143 C. C. A. 87.) * * * But, while the amount of salary fixed by the board of directors is presumptively valid, it is not conclusively so, because the Government may inquire whether the amount paid is salary or something else. Admittedly the Government has a right to collect taxes on net income of a corporation, based on profits after all ordinary and necessary expenses, including salaries, are paid. It has a right, therefore, to attack the action of a board of directors and show by evidence, not that a given salary is too much, but that, in the circumstances, the whole or some part of it is not salary at all, but is profits diverted to a stockholding officer, under the guise of salary and as such, is subject to taxation.
>
> Of the same opinion was the learned trial judge, though in entering judgment of non-suit he raised and ruled upon a second question which was, not whether the salaries paid were commensurate with the services rendered, but whether there was evidence which would sustain a finding that the sums paid were not all salaries but were part profits.
>
> On this evidence we think a jury could find that, as the increase of Bilyeu's salary as president was made without a corresponding increase of service or business responsibility—in fact, in the face of a

> progressive decrease of service and responsibility—the amount paid him was not all for services rendered. (*U. S. vs. Philadelphia Knitting Mills Co.*, 273 Fed. 657, 658-660.)

In *Becker Bros. vs. United States*, the Circuit Court of Appeals for the Second Circuit again (in June, 1925), under the 1909 Corporation Excise Tax Act and the 1913 Revenue Act, held that the salaries which are paid, in order to constitute an allowable deduction, must be a reasonable and fair compensation for the services rendered. The court said:

> The first question to be considered is whether an error was committed in not deducting from the gross income the so-called salary of "85 per cent of the net profits" which the corporation agreed to pay annually to Jacob H. Becker as general manager of its business. The United States in fixing the amount of the tax assessed against defendant, declined to deduct 85 per cent of the profits as being the salary of Becker for his services, and instead deducted in each year only $10,000, claiming that such amount was a reasonable compensation for the services he rendered. There can be doubt that the corporation was entitled to deduct from the income it received all the ordinary and necessary expenses incurred in carrying on its business, including a reasonable compensation to its officers and employees. But the salaries which are paid in order to constitute an allowable deduction must be a reasonable and fair compensation for the services rendered. The expenses which can be deducted are the "ordinary and necessary expenses." If a corporation sees fit to pay its employees extraordinary, unusual, and extravagant salaries, distributing the profits of the business in the guise of salaries to its officers, who hold the stock and control its affairs, such salaries manifestly do not constitute the "ordinary and necessary expenses" of the business, which can be de-

> ducted under the statute. The government is not bound or concluded either by any resolution which the corporation adopts, or by its method of keeping its books, upon the question as to whether any particular payment is a salary payment or a division of surplus. (*Becker Bros. vs. United States,* 7 Fed. (2d) 3, 6-7.)

No authorities have been found questioning in any way these statements.

In the case in hand, claimant asked "In justice and equity" that the same percentage be allowed in 1917 as in 1918, and this was agreed to by the Commissioner, and 16% was allowed instead of 32%.

Therefore, the Commissioner allowed to be deducted as compensation to the directors for 1917 over $181,000.00 to one, $25,000.00 to another, $103,000.00 to each of two, $155,000.00 to another, $51,000.00 to each of three, and $57,000.00 to the two who were in Germany. These are certainly stupendous sums for directors' compensation, and even these, which were allowed, would be extraordinary, and not ordinary expenses.

CONCLUSION

It is submitted that all of the taxes of claimant for 1917 were agreed to, settled, and compromised, and claimant may not now seek to have one item of that settlement set aside. That the amounts paid the directors were from net profits after expenses had been paid, they were not salaries, they were extraordinary and unusual, and were not ordinary or necessary expenses of the corporation. That these amounts were not paid for services rendered or in proportion thereto. And that even the amounts agreed to and allowed by the Commissioner were more than reason-

able, and were more than need have been allowed, if any such payment must be allowed as a deduction. That the petition should be dismissed.

Respectfully submitted,

HERMAN J. GALLOWAY,
Assistant Attorney General.

R. C. WILLIAMSON,
Attorney.

(Credit in the preparation of this brief is acknowledged to Frederick W. Dewart, Special Attorney, Bureau of Internal Revenue.)

Decision of Court of Claims

The Court of Claims, by a unanimous decision in which Judges Moss, Graham, Hay, Booth and Chief Justice Campbell participated, sustained the contention of the Government that the various tax matters of the plaintiff for 1917 were finally settled by compromise and mutual agreement executed by both, and that, under the circumstances, the plaintiff should not be allowed a recovery, the opinion, in part, reading as follows:

> "It is not claimed by the Government that plaintiff's taxes were settled under the provisions of Section 3229. The theory upon which its defense on this point is based is that an agreement was entered into between plaintiff and the Commissioner of Internal Revenue under which plaintiff accepted the partial disallowance as to compensation, and also received certain concessions as to other disputed items, the benefit of which it still enjoys, and that, therefore, plaintiff is estopped from recovery in this action. In addition to the question of compensation there was pending at the same time and for the same year the question of depreciation and also the question of reserves charged to expenses. These items involved important amounts. All matters in dispute between plaintiff and the Government were settled, and the 1917 taxes were paid in accordance with the agreements theretofore reached in conference in the Internal Revenue Bureau. The negotiations in the bureau extended over a period of several months, involving considerable correspondence and numerous conferences."
>
> * * * * *
>
> "With the payment of the tax under the circumstances surrounding this case the agreement, which is mentioned in the record as a 'gentlemen's agreement,' became in legal effect as executed contract of settlement. Plaintiff now seeks to recover on

account of the particular item, which it regards as unfavorable to its interests, and at the same time hold to the advantage derived from the settlement of other items in dispute involved in the same general settlement.

It is the opinion of the court that plaintiff should not be allowed a recovery. It is therefore adjudged that the petition herein should be, and the same is hereby, dismissed."

Further Discussion of Estoppel

We further present the brief of the Government in reply to the brief of claimant on the motion for a new trial in the Court of Claims. In so doing, we respectfully disagree with the contention of the Government therein that the executed agreement of compromise and settlement in the case at bar was not binding. In fairness to counsel for the Government, we here print the reply brief in its entirety. We adopt the statement of facts and that portion of the reply brief supporting the contention that petitioner was estopped to question the adjustment to the particular item involved in this suit.

The brief is as follows:

In the Court of Claims of the United States

No. D—747

BOTANY WORSTED MILLS

vs.

THE UNITED STATES

ANSWER TO CLAIMANT'S PETITION FOR REHEARING AND NEW TRIAL

(May 21, 1927)

As the brief of claimant on the motion for new trial seems to be beside the law and the decision of the Court in this case it is deemed advisable to file a short answer thereto.

The Court's nineteenth finding of fact is as follows:

> An investigation of the books of the plaintiff by a representative of the defendant disclosed to the Commissioner of Internal Revenue the necessity of making a different assessment against the plaintiff than appeared due from its said return for the year ending November 30, 1917. The taxes for the said year were to be determined by the settlement of questions relating to the bonus paid to the company's directors, excessive depreciation charged off on the books of the company, and reserves charged to expenses.
>
> After much correspondence and numerous conferences extending over a period of several months in which the plaintiff was represented by its attorney, John Quinn, and by its assistant treasurer, W. J. Helmer, and other parties, and the defendant represented by Sidney Alexander, chief of the special audit section, Bureau of Internal Revenue, and others of his official associates, a com-

promise was agreed to as to all of the differences. In the said conferences Alexander informed Quinn that in view of the fact that the organization controlled by the Alien Property Custodian had considered the compensation paid to the directors for the year 1918 as being fair and reasonable, the same conclusion "could be reached upon the part of the Government in considering it a fair and reasonable amount for 1917." The results of the said conferences were reported by Quinn to the plaintiff's board of directors from time to time during their continuance.

The following is an excerpt from the minutes of a meeting of plaintiff's board of directors held April 23, 1920:

"• • • Counsel succeeded some time ago in effecting a compromise on the question of bonuses to directors and the amount transferred from depreciation on buildings and machinery to the surplus account, as to which counsel made a report to the board and which was satisfactory to the board.

"The company then received an assessment of $1,144,832[illegible]1.02, covering the years 1916, 1917, and part of 1918. This assessment was the subject of careful consideration by the company and conferences with counsel and conferences with the department by counsel, and the subject of supplemental memoranda and hearings.

"At the last hearing there was a great deal of discussion in regard to the reluctance of the department to allow for those years the large items of bonuses and deductions for reserves, but they finally agreed to allow the bonuses to employees, the deductions for reserves, and all of counsel's other points.

"Counsel arranged an adjustment of the bonuses for the year 1917 on the same relative basis as the bonuses for the year 1918, approved by the reorganized board.

"Assuming that the bonus to directors in 1917 will remain as originally agreed to—that is, on the relative basis of the 1918 bonus—the additional tax to the Government for the years 1916, 1917, and 1918 will amount to $718,770.11.

"This shows a saving to the company between the original amount claimed and what will be the final assessment of $663,507.16.

"The Government accepted the contentions presented by counsel for the company on all of the essential questions that counsel for the company and the officers of the company felt were right and proper under the law and facts."

Thereafter amended returns were prepared and executed by plaintiff's executive officers, based upon the figures as agreed upon in the said conferences, and were filed with the Commissioner of Internal Revenue, together with documentary evidence which it was agreed upon at the last conference should be furnished, and the tax so computed, with a slight change not material to this case, was paid by the plaintiff.

The above-quoted finding of fact is supported by the evidence in the record and by the findings of Commissioner Whaley. It thus appears that the adjustment of claimant's tax liability for the year ending November 30, 1917, involved the settlement of disputes relating to proper compensation of officers, correct depreciation, and the proper treatment, for invested capital purposes, of certain reserves charged to expense. After extended correspondence and numerous conferences lasting over a priod of months a settlement of the items was agreed upon by the representatives of the taxpayer and of the Government. That a mutual adjustment of all the differences was arrived at by an attempt in good faith to give and take with respect to the disputed items is shown by the

excerpts from the minutes of the taxpayer's board of directors and the findings of fact.

Under the facts as found by the Court in this case it appears that concessions were made by the Government because of concessions being made by the taxpayer; that in the absence of such mutual concessions these adjustments would not have been made. Under the circumstances as briefly outlined above, the claimant, while retaining the benefits of concessions made by the Government, seeks to repudiate the concessions made by it.

Section 1312 of the Revenue Act of 1924, authorizing the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, to enter into an agreement finally settling the tax liability of a citizen, was not in effect when, in 1920, the tax here involved was adjusted. The only provision of the statute then in effect authorizing the compromise of taxes was Section 3229 of the Revised Statutes. The Government does not contend, nor does the Court's opinion in this case hold, that any officer of the Bureau of Internal Revenue had authority to enter into a binding contract with respect to the income-tax liability of the claimant in the case at bar.

The proposition that no officer or employee of the Bureau of Internal Revenue had authority to bind the Government by contract except as authorized by law is so well settled that it is unnecessary to refer to the pertinent statutes and the decisions of the courts.

As stated by the Court at page 11 of its opinion the Government contends that since the taxpayer "accepted the partial disallowance as to compensation, and also received certain concessions as to other disputed items, the benefit of which it still enjoys * * * plaintiff is estopped from recovery in this action.

That a taxpayer may be so estopped by his conduct in dealing with the representatives of the Government is abundantly settled by authority—

> *McDonald Coal Company* v. *Lewellyn*, 9 Fed. (2) 994; affirmed 16 Fed. (2) 274.
>
> *McDonald Coal Company* v. *Heiner*, 9 Fed. (2) 992.

In this *McDonald case* the Plaintiff did business as a corporation, and the stockholders also did business as a partnership under the same name. The corporation filed the tax returns for certain years and paid the taxes. Later it sought to recover these taxes claiming the taxes were due from the partnership. The court said:

> They ought not in honesty and good faith to be permitted to represent themselves to be a corporation, file corporate tax returns, file copies of minutes of corporate action, certify the sale and transfer of partnership property to the corporation, and then deny the incorporation when it suits the convenience of the incorporators. *McDonald Coal Company* v. *Heiner*, 9 Fed. (2) 992.

There is in this *McDonald case* no suggestion of contract or mutual agreement or anything of the kind, but it is an application of the general rule of equity and good conscience.

It is the general rule of law that where differences between parties have been adjusted by mutual concessions, the adjustment or settlement, which has been executed in accordance therewith, may not be opened up by a party without the restoration of the *status quo*.

It would be against equity and good conscience to allow the party to retain the concessions granted him and at the same time allow him to recover back the concessions he had given to the other party.

The Government may not assess additional taxes after five years after the return was due or filed. This five years would expire in the case in hand March 15, 1923. This action was begun September 12, 1924, so that the Government was at that time and is now barred from any recovery against the taxpayer on items for the year 1917.

Wherever a contract or settlement or arrangement, which is not conclusive or binding on the parties, is sought to be set aside, it is held that good faith, honesty, and fair dealing require the plaintiff, as a condition precedent, to restore the conditions to the *status quo.*

The books are full of these cases and this doctrine.

Grymes v. *Saunders,* 93 U. S. 55.

McLean v. *Clapp,* 141 U. S. 429.

Cook v. *Fidelity & Deposit Company,* 167 Fed. 95.

Hill v. *Northern Pacific Ry. Company,* 113 Fed. 914.

Walker v. *Alamo Food Company,* 16 Fed. (2) 694.

The complainant in this case seeks to ignore this universal principle of law, to hold to the benefits he has received and to recover back what he gave.

This court has rightly held that he may not do this, and the decision of this court is just and right.

Respectfully submitted,

HERMAN J. GALLOWAY,
Assistant Attorney General.

R. C. WILLIAMSON,
Attorney.

NOTE.—This brief has been prepared by A. W. Gregg, General Counsel, and Frederick W. Dewart, Special Attorney, Bureau of Internal Revenue.

SUPPLEMENTAL ARGUMENT

Supplemental to the argument in the Government briefs quoted, we beg to add the following:

The administration of the income tax laws is vested in the Treasury Department, and the administrative functions are vested in the Commissioner of Internal Revenue. His acts, within the scope of his authority, must be considered the official acts of the Secretary of the Treasury, and are binding on the Government.

Soule vs. United States, 100 U. S., 8;

Hamilton vs. Dillon, 21 Wall., 73;

Re Huttman, 70 Fed. Rep., 699;

Parish vs. United States, 100 U. S., 500.

The Commissioner of Internal Revenue had the power and it was his duty to examine the taxpayer's return, and for the purposes of taxation, investigate the facts, confer with the taxpayer and its representatives, hold hearings, and to exercise his judgment in reaching his conclusions as to the reasonable and proper amount of compensation for the services of directors allowable as ordinary and necessary expenses. This, the Commissioner did. We believe it material to this issue to bear in mind that all the questions involved in this settlement were of fact, the determination of which involved judgment and opinion, which it was within the scope of the authority and the duty of the Commissioner to exercise. They were not certain or fixed amounts which could be determined with mathematical certainty. There was room for wide differences of opinion and judgment of reasonable men as to what allowances would have been fair and reasonable. In the agreement of settlement and its return based

thereon and in accordance therewith, the taxpayer accepted and agreed to the amount of such compensation as determined and allowed by the Commissioner, in consideration of the determinations and allowances made by the Commissioner on the other items in dispute, which all involved like exercise of judgment and discretion in their determination, and which the taxpayer considered were determined and adjusted to his advantage. The general settlement covered all of these disputed items. It was performed by both the government and the taxpayer. The taxpayer paid the net additional tax assessed on account of the adjustments agreed upon, including the additional tax on account of the particular item regarding the allowable compensation to directors for services, to the determination of which by the Commissioner, the taxpayer had agreed. The case was closed. The statute of limitations ran against the Government as to all the other items in the settlement on March 15, 1923. This suit was begun by the taxpayer against the Government on September 14, 1924. There was no fraud, mistake of fact, error in mathematical calculation or new material evidence. By this suit, the taxpayer seeks to retain all the advantages he gained in the settlement and at the same time recover back what the Commissioner determined and what the taxpayer agreed in that settlement was due the Government on the particular item involved in this suit.

It is difficult for us to believe that the taxpayer, under these circumstances, should be permitted to repudiate and set aside a part of the executed agreement of settlement which it alleges was to its disadvantage, the benefits of which agreement as a whole, the taxpayer retains, and of which it cannot be divested. We see no equity or force in the contention that the Commissioner had no express statutory authority to enter into such agreement of settlement, therefore, the taxpayer is relieved from its binding

force, and may recover in this suit on one item while holding the benefits derived on the other items included in the general settlement.

We respectfully submit, however, that the Commissioner of Internal Revenue, possessed of the general authority required for the efficient administration of the revenue act, is not required to find express statutory authority for all his acts in order to establish their validity or binding force. An administrative officer charged with the administration of statutes cannot be required to find express statutory authority for every step in the exercise of his discretionary powers. This was long ago pointed out by this Court. In *United States vs. McDaniel*, 7 Pet. 1 (1833) at pages 13-14, this Court said:

> "A practical knowledge of the action of any one of the great departments of the government, must convince every person, that the head of a department, in the distribution of its duties and responsibilities is often compelled to exercise his discretion. He is limited in the exercise of his powers by the law; but it does not follow, that he must show statutory provision for everything he does. No government could be administered on such principles. To attempt to regulate, by law, the minute movements of every part of the complicated machinery of government, would evince a most unpardonable ignorance on the subject. Whilst the great outlines of its movements may be marked out, and limitations imposed on the exercise of its powers, there are numberless things which must be done, that can neither be anticipated nor defined, and which are essential to the proper action of the government."

The petitioner is asserting a pecuniary demand against the United States, and has brought suit for the recovery thereof against the Government in the Court of Claims.

We respectfully submit he should be held to the same degree of fair dealing and good faith which a long list of authorities require should characterize the sovereign in dealing with its citizens.

United States vs. Johnston, 124 U. S., 236;

United States vs. Philadelphia and Reading R. R. Co., 123 U. S., 113;

Utah Power & Light Co. vs. United States, 230 Fed., 328, 342;

United States vs. Williamette Valley and C. M. Wagon-Road Co., 54 Fed., 807, 811;

Walker vs. United States, 139 Fed., 409; 148 Fed., 1022;

State of Iowa vs. Carr, 191 Fed., 257;

United States vs. Stinson, 125 Fed., 907; 197 U. S., 200, 204;

Hemmer vs. United States, 204 Fed., 898;

Pan American Pet. Co., vs. United States, 9 Fed., 761;

United States vs. Midway Northern Oil Co., 232 Fed., 619;

State of Indiana vs. Milk, 11 Fed., 389;

United States vs. Hill, 120 U. S., 169, 182;

Western Union Tel. Co. vs. Julian, 169 Fed., 166, 175;

Scott County vs. Advance-Rumley Thrasher Co., 288 Fed., 739;

Bates & Guild Co. vs. Payne, 194 U. S., 106, 108-109;

Jackson vs. United States, 19 Ct. of Cl., 504;

Waddell vs. United States, 25 Ct. of Cl., 323;

Re Presbyterian Church, 9 Op. Atty. Gen., 100;

Dugan vs. United States, 34 Ct. of Cl., 458;

First Nat'l Bank of Greencastle vs. United States, 15 Ct. of Cl., 225;

United States vs. Kaufman, 96 U. S., 567, 570;

Penrose vs. Skinner, 278 Fed., 284, 286; 298 Fed. 335;

United States vs. Savings Bank, 104 U. S., 728;

Muser vs. Magone, 155 U. S., 240;

United States vs. Chandler-Dunbar Water Power Co., 152 Fed., 41, 81 C. C. A. 221.

In *United States vs. Johnston*, 124 U. S., 236, the accounts of a special agent of the Treasury Department designated to collect abandoned cotton in the southern states during and after the war were closed by the Department in a rather irregular manner, and subsequently the Government sought to reopen the accounts. The Supreme Court held this should not be done, saying (p. 254):

> "The utmost that the record establishes is that there were irregularities, perhaps carelessness, in the final closing of defendant's account with the Government. It may be that he should have been required to present more satisfactory evidence than it may be supposed from the record he did in fact present. These considerations, however, even if entitled to weight as matter of law, lose much force after the lapse of years without action upon them by the Government. The defendant ought not now to be held to the same strictness

of proof that might justly have been required of him when all the circumstances connected with the cotton in question could have been readily established by competent evidence. We are of opinion that no case is made by the Government to invalidate the settlement of defendant's accounts. We concur with the referee when he says that 'it would be an exceedingly dangerous doctrine that settled accounts where the United States had acted on the settlement and paid the balance found due on the basis of that settlement, could be opened or set aside, merely because some of the prescribed steps in the accounting which it was the duty of a head of a department to see had been taken, had been in fact omitted; or, if they could be so opened and set aside on account of technical irregularities in the allowance of expenses years afterwards, when the remedy of the party against the United States is barred by the statute of limitations, and the remedies of the United States on the other side are intact, owing to its not being subject to any act of limitation'."

In *United States vs. Midway-Northern Oil Co.*, 232 Fed., 619, 631, the Court said:

"Where the sovereign comes into a court of equity, asserting a pecuniary demand against a citizen, or to protect its proprietary interest, its claims appeal, generally speaking, to the conscience of the Chancellor with the same, but no greater or less, force than that of a private individual under like circumstances, and it is the duty of the court to withhold relief, except upon terms which do justice to the citizen or subject, as determined by the jurisprudence of the forum. *Sweet vs. U. S.*, 228 Fed., 421,—C. C. A.—, and authorities cited; *Walker vs. U. S.*, (C. C.) 139 Fed., 409; *U. S. vs. Detroit Lumber Co.*, 200 U. S., 321, 26 Sup. Ct. 282, 50 L. Ed. 499; *Hemmer vs. U. S.*, 204 Fed., 898, 123 C. C. A. 194; *Iowa vs. Carr*, 191 Fed., 257, 112, C. C. A. 447. For, as said by Mr. Justice Severens,

speaking for the court in *United States vs. Chandler-Dunbar Water Power Co.*, 152 Fed., 41, 81 C. C. A. 221:

> When it (the sovereign) 'sues in equity as a private suitor on a cause of action relating to its proprietary interests, it is held to be affected by those equities which are recognized as fundamental in controversies between private parties. And why should this not be so? It derogates from the dignity and character of the Government to suppose that, formed as it is to secure impartial justice between individuals, it may nevertheless, in the conduct of its own affairs, without regard to the principles it represents, perpetrate upon the citizens wrongs which it would promptly condemn if practised by one of them upon another.' "

In *United States vs. Hill*, 120 U. S., 169, 182, the Court said:

> "This principle has been applied as a wholesome one for the establishment and enforcement of justice in many cases in this court, not only between man and man, but between the Government and those who deal with it, and put faith in the action of its constitutional authorities, judicial, executive and administrative."

In *Western Union Tel. Co. vs. Julian*, 169 Fed., 166, 175, the Court said:

> "It is equally well settled that the department of the government which represents the sovereignty of the state or of the United States in dealing with any particular matter may, by its conduct, estop the state or the United States, as the case may be, from arbitrarily withdrawing the grant of a right, and disappointing the just expectations which its laws and conduct raised, to the prejudice of one who has relied and acted on its laws and

the acts of its officers, when such action of the state will forfeit his property, rip up completed transactions, or prevent the future exercise of rights which vest in and flow from the original transaction. *United States vs. Walker* (C. C.), 139 Fed., 412, and authorities there cited."

In *Walker vs. United States,* 139 Fed., 409, affirmed in 148 Fed., 1022 (C. C. App. 5th C.) the Court said (p. 413):

"The underlying principle of all the decisions is that, when the sovereign comes into court to assert a pecuniary demand against the citizen the court has authority, and is under duty, to withhold relief to the sovereign, except upon terms which do justice to the citizen or subject, as determined by the jurisprudence of the forum in like subject-matter between man and man. The acts or omissions of its officers, if they be authorized to bind the United States or to shape its course of conduct as to a particular transaction, and they have acted within the purview of their authority, may in a proper case work an estoppel against the Government. *Lindsay vs. Hawes,* 2 Black, 560, 17 L. Ed. 265; *Davis vs. Gray,* 16 Wall., 203, 21 L. Ed. 447; *U. S. vs. Bank of Metropolis,* 15 Pet., 392, 10 L. Ed. 774; *Sinking Fund Cases,* 99 U. S., 719, 25 L. Ed. 496; *U. S. vs. Barker,* 12 Wheat., 559, 6 L. Ed. 728; *Cooke vs. U. S.,* 91 U. S., 398, 23 L. Ed. 237; *Duval vs. U. S.,* 25 Ct. Cl. 60; *Hartson vs. U. S.,* 21 Ct. Cl. 456. The principle that the sovereign is bound by his own acts, and those of his lawfully authorized agents within the purview of their authority, is a wholesome one, and requires the courts to visit an estoppel upon the sovereign in a proper case, where he invokes judicial action. While the application of the doctrine is attended with difficulty under our institutions, where sovereignty of the United States does not reside in any one person or collection of persons, that

difficulty is no reason for rejecting the operation of the principle, if the facts of the particular case will admit of its application.

• • • Whenever an affirmative act is necessary on behalf of the United States to effect or enforce a pecuniary right against an individual, the officer or department whose duty it is to do that act represents the United States as to the matter, and it is bound by his action or nonaction. *United States vs. Barker*, 12 Wheat., 559 6 L. Ed. 728; *United States vs. Bank*, 15 Pet., 377, 10 L. Ed. 774."

It has been said many times by the Courts that the equitable claims of the United States appeal to the conscience of the Chancellor with the same but with no greater or less force than would those of an individual under like circumstances.

State of Iowa vs. Carr, 191 Fed., 257, (C. C. App. 8th C.);

United States vs. Stinson, 125 F., 907; affirmed in 197 U. S., 200, 204;

Hemmer vs. United States, 204 Fed., 898 (C. C. App. 8th C.);

Pan-American Pet. Co. vs. United States, 9 F. (2nd) 761 (C. C. App. 9th C.);

United States vs. Midway Northern Oil Co., 232 Fed., 619.

In the early case of *State vs. Milk*, 11 Fed., 389, the Court said:

"Resolute good faith should characterize the conduct of States in their dealings with individuals, and there is no reason, in morals or in law, that will exempt them from the doctrine of estoppel" (citing cases).

We respectfully submit that the government and citizen enter this Court under conditions which place them on an equal footing and that the petitioner should be held to the same degree of good faith and fair dealing which should characterize the government in dealing with its citizens.

CONCLUSION

We respectfully submit that the executed agreement of settlement is binding; that the petitioner is estopped to question the settlement; and that the judgment below should be affirmed.

Respectfully submitted,

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CLARENCE E. WILSON.

April 30, 1926.